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DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: 2 YEARS LATER

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY UNITED STATES SENATE

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Tuesday, July 17, 2012

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

The Committee met, pursuant to notice, at 10:11 a.m., in room 328A, Russell Senate Office Building, Hon. Debbie Stabenow, Chairwoman of the Committee, presiding.

Present: Senators Stabenow, Harkin, Klobuchar, Roberts, Lugar, Boozman, Grassley and Thune.

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

Chairwoman STABENOW. Good morning. We will call to order the Committee on Agriculture, Nutrition and Forestry, and we welcome our witnesses and everyone that has joined us today.

Let me just say at the beginning that for our first panel we have agreed, because of the importance of a number of issues that we will be talking about today, to do two rounds, and we will be giving each member seven minutes a round. So we will have some additional time to be able to have a full, important discussion today.

It has been two years since Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. In that time, there has been an open rulemaking process with multiple opportunities for public input. And as I have said before, it is extremely important that we get the rules done right.

Recently, the Joint Product Definition Rule was made final, which along with the Entity Definition Rule, starts the clock on compliance. This is a significant step toward greater transparency and final implementation of key provisions of the law. I also appreciate the Commission's work to finalize the end user rules, yet we are still waiting on a number of significant rules to be made final or to go into effect, including those on capital and margin, clearing and trading, block trading, conflicts of interest, and swap execution facilities.

There is no question that it is important to coordinate the rules between agencies and harmonize them internationally. But it is also critical to get them done. How many rules are still—while so many rules are still unwritten, many derivatives are still trading in the dark, and some financial institutions are still taking risks that threaten our economy.

If anyone is wondering why we need these rules, all you have to do today is turn on the news. There is the LIBOR rate setting scandal, the euro zone prices, the demise of Peregrine Financial Group, significant trading losses at J.P. Morgan, and the MF Global bankruptcy. And you cannot blame people for thinking what is next.

We need these markets to have integrity and market participants need certainty so that they can plan for compliance and make business decisions for the coming months and years. Job creating companies and farmers and ranchers need to know that these markets are safe for trading and hedging their risks. And again, American families need to know that their jobs are not going to disappear again because of excessive risk taking by a reckless few.

I understand there have been significant hurdles. We have seen proposals to defund the agencies charged with protecting our markets, even as events at home and around the globe continue to highlight the need for effective oversight. We cannot forget that when this law was passed we were on a brink of a global economic crisis, a crisis that left eight million Americans out of work, home mortgages under water, and small businesses closed forever.

Despite the challenges, I know that the individuals charged with writing these rules have been working very hard in the face of great challenges and difficulty, and I would like to commend everyone involved and their staffs for what I know has been a tremendous amount of hard work.

I am eager to hear from our witnesses today about where we are in the rulemaking process, what challenges they are facing as they try to complete these rules, and what this Committee can do to support those efforts. So again, I would welcome both of our first witnesses. We appreciate your efforts and leadership, and I would now turn now to Senator Roberts.

STATEMENT OF HON. PAT ROBERTS, U.S. SENATOR FROM THE STATE OF KANSAS

Senator ROBERTS. Thank you Madam Chairwoman. I thank you for calling this hearing this morning to discuss the Dodd-Frank bill two years after it has become law. At first, in light of the LIBOR situation, you brought it up Madam Chairwoman, very appropriately, which we now have learned the CFTC knew about back in 2008.

I have serious concerns why it has taken until the end of Chairman Gensler's term for the CFTC to act. This is 2012, four years after the Commission was first made aware of the potential underreporting. This Committee and the American taxpayer deserve an explanation. There is going to be more shoes to drop on this issue.

Typically, two years after a major piece of legislation like Dodd-Frank has passed, we would hear an update from stakeholders about how the law is affecting the real world. We would hear from the agencies in charge of implementing the law about the things that Congress did well, and for sure, some of the things that we might need to consider changing.

But when it comes to Dodd-Frank, stakeholders are still confused and frustrated and begging to be told what is expected of them. The courts have already thrown out a major rule or inadequate cost benefit analysis and other rules are being challenged on the same basis. The agencies are here today to explain why they apparently cannot cooperate and why it is taking them over two years to figure out a way to cooperate with the rest of the world.

Here we are two years later and we still have no plan. The CFTC has told no one how it plans to coordinate the implementation of the over 30 rules and thousands and thousands of pages of new regulations it has created. No one knows how all these rules will fit together or how much, if any, coordination there has been between the agencies in charge of implementing Dodd-Frank domestically or internationally.

I want to be very clear on this point. Stakeholders are certainly not opposed to the certainty that goes along with Dodd-Frank's mandate that swaps be cleared. In fact, many firms have already spent millions of dollars in an effort to be ready to implement the Dodd-Frank rules. What these folks want and what they have been asking for these past few years is certainty and direction from the CFTC as to what they need to do toward implementing what Commissioner Sommers has properly labeled Chairman Gensler's intergalactic commerce clause of regulation. The problem is that no one knows what Chairman Gensler's plan is. Chairman Gensler's plan two years later is disjointed. It's incomplete, and now we find out it is just interpretive, and therefore, not enforceable by law.

Regardless, the CFTC is about to initiate its 60-day countdown to implementation, and in doing so, potentially sets in motion a series of events that will send further shock waves of uncertainty through our derivative users and industry. What happens at the end of the 60 days, which should be on or about October 1, when our domestic users of derivatives international regulators, or international users of derivatives are not ready? Will the Commission offer waivers? Or will participants simply face massive fines and enforcement actions by the CFTC?

Is the CFTC about to create its own system of systemic risk? And if this were not enough, the CFTC is not doing a good job, in my opinion, of what it was created to do, and that is to police the financial streets. It appears as though Chairman Gensler's CFTC is too busy working on this intergalactic plan to have a conversation with anyone, including fellow commissioners, or the Securities and Exchange Commission, about implementing recommendations in the aftermath of the MF Global bankruptcy.

Now the chairman set a unique precedent by taking a non-participating role and wanted to step aside from his relationship with Jon Corzine in the investigation of MF Global. I understand that, but he made it clear to other CFTC commissioners, staff and outside parties that he wanted to keep control of the recommendations that came out of that investigation. My question, especially in light of the failure of Peregrine, PFGBest, last week, the second major failure of this nature on his watch, where are the recommendations? Investors, stakeholders and others need confidence in the system.

Now, Commissioner O'Malia said it well when he called for using the best, most innovative and least burdensome tools to meet the regulatory ends laid out in the Commodity Exchange Act. Chairman Gensler, CFTC, should be focused on doing exactly that and overseeing the rules on the books rather than requesting new multitudes of staff and looking for justification to regulate the world, any entity doing business with a U.S. person, therefore, the world. Again, with the regulations we have seen, labeled interpretive and not enforceable by law.

Madam Chairwoman, I look forward to hearing from the chairman on how we land the spaceship and how he plans to work with the SEC and the real world of frustrated and worried stakeholders to implement what Dodd-Frank intended. Thank you.

Chairwoman STABENOW. Thank you very much, Senator Roberts. We certainly have a lot of things to discuss today, we welcome both of you here.

Let me first introduce our first panelist, Gary Gensler. Mr. Gensler is the Chairman of the Commodities Futures Trading Commission, as we know, and has led the effort to implement provisions, most importantly, title VII of Dodd-Frank, into the derivatives marketplace. Prior to his appointment, Mr. Gensler held two positions with the Treasury under the Clinton Administration. Mr. Gensler served as Undersecretary of the Treasury for Domestic Finance and Assistant Secretary of the Treasury for Financial Markets. We welcome Chairman Gensler.

Let me also introduce our second panelist, Robert Cook. Mr. Cook is the director of the Division of Trading and Markets at the Securities and Exchange Commission. Mr. Cook has oversight of the standards for fair, orderly and efficient markets. Mr. Cook is a nationwide leading practitioner on broker-dealer and market regulation. We welcome you this morning, as well, and we will start with Chairman Gensler.

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

Mr. GENSLER. Good morning, Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. Thank you for inviting me here to talk about the swaps markets reforms. I also want to comment on LIBOR and the recent events related to Peregrine.

The Commission has made significant progress in implementing Congress' commonsense rules of the road, bringing transparency to and lowering risks of the swaps market. Four years after the fact, and two years after the passage of the Dodd-Frank Act, Americans are still struggling from the worst economic crisis experienced since the Great Depression.

Eight million Americans lost their jobs. Millions of families lost their homes and thousands of businesses shuttered. With 35 rules completed, we are increasingly moving from the rule writing process to the implementation of reforms, and I look forward to discussing that with this Committee, and Ranking Member Roberts' questions, very good questions, I want to go through.

Light will begin though to shine on the swaps market this fall when, yes, around October swaps price and volume information will be publicly reported for the first time in real time. Regulators will get their first full window into these markets. Swap dealers will begin to register provisionally at first to come under comprehensive regulation and aggregate spot-month position limits will apply to both futures and swaps. We look forward to completing other swaps markets reforms this year, including those related to determining swaps must be cleared in pre-trade transparency to promote competition. And as we finalize cross-border guidance, we will recall the lessons of past crises.

Financial transactions executed offshore by U.S. financial institutions often send risk right back here to our shores. It was true in the London and Cayman Island affiliates of AIG, of Lehman Brothers, of Citigroup, of Bear Stearns and a decade earlier, Long-Term Capital Management, all with affiliates in London and Cayman Islands, crashing back here. The recent events of JPMorgan Chase, again, why do they call it the London whale? Executed in the London branch; again, a stark reminder.

The LIBOR index at the center of the capital markets for both borrowing and derivatives contracts is but another example of our globally interconnected financial system. Hundreds of trillions of dollars of derivatives transactions here and abroad are based on LIBOR. People taking out small business loans, credit cards, mortgages, often in the fine print there is a reference to this variable rate called LIBOR as big as—as well as big companies doing complex transactions.

What do they rely on? The honesty of this benchmark. Banks must not attempt to influence LIBOR or other of its sister rates like Euribor, and they cannot do it if they are concerned about their reputation, and they cannot do it if they are concerned about their profitability. It is just wrong and against the law. So if these key benchmarks are based on observable transactions, borrowers and lenders and derivatives users around the globe benefit. But if these key benchmarks are not based on honest submissions, we all lose.

Before I close, I would like to just review the recent events at Peregrine. On July 10th, the CFTC brought a federal action alleging $200 million fraud, misappropriation of customer funds. The firm's owner was arrested and charged criminally. Simply put, the evidence alleged in these cases is that Mr. Wasendorf embezzled millions of dollars, manufactured phony bank statements, forged signatures and created fake bank addresses.

The charges against him are that he took customers' funds right out of the bank and lied about it for years. Peregrine is a futures commission merchant registered at the CFTC. The National Futures Association, the self-regulatory organization responsible for frontline oversight of Peregrine, is required to conduct periodic audits of Peregrine. In addition, there has to be an annual review by an independent CPA. Just like the police cannot prevent all bank robberies, market regulators cannot prevent all financial fraud.

Having said that, the system failed to protect Peregrine's customers, and we all must do better. The Commission has been actively working to improve protections of customer funds. We have finalized four separate critical rules in this regard. We also worked with the National Futures Association and futures industry over these last seven or eight months and finalized last week rules that are new commonsense rules to protect customers.

But the CFTC has been implementing also significant restructuring our oversight of intermediaries. We have hired new leadership of this division and stood up a new examination group nine months ago. Looking forward though, I believe it is critical that we further update our rules, giving regulators direct electronic access to all bank accounts and custodial accounts.

Now we do not yet know the full facts of the circumstances, but we are committed at the CFTC to conduct a full review of the CFTC's and the self-regulatory functions, examination and audit oversight of futures commission merchants, looking openly for further improvements. We must do that. We must do everything within our authorities and resources to strengthen our oversight programs and the protection of customer funds, and I look forward to taking your questions.

[The prepared statement of Mr. Gensler can be found on page 59 in the appendix.]

Chairwoman STABENOW. Mr. Cook, welcome.

STATEMENT OF ROBERT COOK, DIRECTOR, DIVISION OF TRADING AND MARKET, SECURITIES AND EXCHANGE COMMISSION

Mr. COOK. Thank you, Chairman Stabenow, Ranking Member Roberts, and members of the Committee. Good morning. My name is Robert Cook, and I am the director of the Securities and Exchange Commission's Division of Trading and Markets. Thank you for the opportunity to testify regarding title VII of the Dodd-Frank Act.

As you know, title VII creates an entirely new regulatory regime for over-the-counter derivatives, and directs the SEC and the CFTC to write a number of rules to implement this regime. The SEC has authority over security-based swaps, while the CFTC has authority over all other swaps which comprise the overwhelming majority of the products subject to title VII.

My testimony today will provide an overview of the SEC's efforts to implement title VII, focusing on developments since Chairman Schapiro's testimony before this Committee in December. Since enactment of the Dodd-Frank Act two years ago, the SEC has proposed most of the rules required by title VII, and we continue to work diligently in coordination with the CFTC and other domestic and foreign regulators to implement all the title's provisions.

In June, the SEC issued a policy statement describing the order in which it expects to require compliance with the Commission's final rules under title VII, and requesting public comment. The policy statement is divided into five broad categories of rules and explains how the compliance dates of these rules would be sequenced by describing the dependencies that exist within and among the categories.

The SEC's approach aims to avoid the disruption and costs that could result if compliance with all the rules were required simultaneously or haphazardly. The policy statement also emphasizes that those subject to the new regulatory requirements will be given adequate, but not excessive time to come into compliance with them.

I am also pleased to report that earlier this month the SEC, acting jointly with the CFTC, adopted final rules and interpretations further defining certain products subject to title VII, including swaps, security-based swaps and security-based swap agreements. In April, again jointly with the CFTC, the SEC adopted final rules and interpretations further defining certain entities subject to title VII, like securities-based swap dealers, and providing guidance regarding the application of the dealer-trader distinction in identifying such entities.

The rulemaking also implemented the Dodd-Frank Act statutory de minimis exception for dealers in a way that recognizes different types of security-based swaps that includes a phase-in designed to promote the orderly roll out of the regulation of security-based swap dealers.

The completion of these two joint rulemakings is a significant milestone in the journey toward the complete implementation of title VII. Beyond these definitional rules, the SEC also this year has adopted rules that establish procedures for its review of certain actions undertaken by clearing agencies, including their submission of information to the SEC about the security-based swaps they plan to accept for clearing.

The rules also require clearing agencies that are designated as systemically important under the Dodd-Frank Act to submit advanced notice of changes to their rules, procedures or operations that could materially affect the nature and level of risk at those clearing agencies. Moving forward, the SEC expects soon to complete the last of the core elements of our proposal phase, rules related to the financial responsibility of security-based swap dealers and major security-based swap participants.

Further, we intend to propose in a single holistic rulemaking rules and interpretative guidance addressing the international implications of title VII. Our cross-border approach will be informed by discussions with the CFTC and fellow regulators in other jurisdictions. I expect that the Commission's proposal will address the international implications of title VII with respect to each of the major registration categories covered by title VII relating to market intermediaries and infrastructures for securities-based swaps, as well as with respect to the transaction-related requirements under title VII in connection with reporting, clearing, and trade execution for security-based swaps.

This publication is intended in part to give investors, market participants, foreign regulators and other interested parties an opportunity to consider as an integrated whole our approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. persons. The Commission therefore, anticipates that this release will be published before the underlying rules addressed in it are finalized so that the comments received can be taken into account in drafting the final rules.

In conclusion, as we continue to implement title VII, we look forward to continuing to work closely with Congress, our fellow regulators, both at home and abroad, and members of the public. Thank you for the opportunity to share our progress and current thinking on the implementation of title VII. I will be happy to answer any questions.

[The prepared statement of Mr. Cook can be found on page 46 in the appendix.]

Chairwoman STABENOW. Thank you very much to both of you. Chairman Gensler, there are a lot of things we want to talk about in this hearing. They are all very important, both in terms of the

Dodd-Frank implementation on title VII, as well as what has happened since then.

Let me start by asking something related to MF Global and to the Peregrine Financial Group, because there is no question that these efforts are devastating to the futures markets. They point to regulatory gaps. You spoke about that in your opening statements and that some things were being done.

Earlier this year after MF Global, I had asked that those involved as market participants give us recommendations and what we should be doing, what they should be doing, what you should be doing. We will be doing a hearing on August 1 specifically on that, but I would like to know from your perspective what is happening. As you are making changes, what else are you doing to protect consumers, instill confidence in the integrity of the futures markets?

I get asked all the time at home by farmers, by grain elevator operators, should I use the futures markets anymore because of their concern about what has happened and their lack of confidence. What are we doing to repair what is really viewed as a broken regulatory system at this point?

Mr. GENSLER. Excellent question. We pulled together market participants in early February into two full days of roundtables, and out of that, good recommendations came forward that the National Futures Association, and we, finalized last week. One was the use of the firm's money that sometimes they put into the customer fund. This is called the excess funds that you remember so well from the events of last fall. That can only be removed if it is more than 25 percent, removed with signatures of the chief executive officer, chief financial officer, some other senior management, and reported directly to the regulators.

We also closed a significant gap that had existed for over 20 years in our rules about foreign futures accounts. There were two methodologies to compute. I am not entirely sure why in the 1980s one was picked, but we have closed that gap as well.

Those are very important changes. Also we have in front of commissioners now a series of recommendations to go further than that. One of them that I highlighted in my opening statement, I really believe that the regulators, the Chicago Mercantile Exchange, the National Futures Association, should have direct and daily electronic access to see what is in the bank accounts, to see what is in the custodial accounts, not relying somewhere on—I mean, of course, the events of Peregrine were about falsifying bank statements and forging signatures and so forth, and we are not going to be able to stop every fraud. But to have the regulators have direct access on a daily basis, I think, is a critical reform. But we need to go further.

Chairwoman STABENOW. If I might just on that point. Is that one of the changes you will be making? Because with technology available today, I do not know why we are not requiring real time oversight of the futures commissions merchants at this point.

Mr. GENSLER. It is I think, a critical reform. It is one we have talked to the NFA, the CME and the Futures Industry Association about. I am hoping that it will have broad support. We need to put it out to public comment, but yes.

Chairwoman STABENOW. Okay. That is great. Talk a little bit about, you know, there is obviously criticism about the regulators failing to do your job and reacting to crises rather than preventative efforts. Could you speak broadly to that?

Mr. GENSLER. Well, we are an agency that ultimately has responsibility for futures and now swaps oversight. We, through statute, have to work with self-regulatory organizations, and that has been appropriated for decades. It is a multi-decade approach. I think the SEC has it similarly. They are the front-line regulators, then we oversee them as well.

But I do think that we need to do more. We need to do more and review that relationship and make sure that we are doing the right things at the CFTC when we examine the examiners, so to speak, as the second line of defense, to ensure that their audits are full and do not miss things.

Chairwoman STABENOW. Mr. Cook, when we look at the SEC—and I appreciate very much the SEC and CFTC working together on definitions and on rules and so on. But at this point, the SEC has, frankly, been behind the CFTC in terms of title VII kind of moving forward and finalizing. I think you finalized about a third of your rules. You have indicated there is a lot coming up in the near future.

But I wonder if you know when the SEC is going to put forth a proposed rule on extraterritoriality and why the SEC chose to propose a rule rather than interpretive guidance?

Mr. COOK. Thank you, Chairman. It is difficult to predict with precision exactly when that rule will come out, but I can tell you it is right in the sweet spot of the focus of the staff right now, together with the final proposing rule we need to implement, which is the rule relating to the financial requirements for securities-based swap dealers, the capital and margin rules. So we are hoping in the next several months we will have those rules in front of the Commission and acted upon.

We are intending to sequence them with the capital and margin rule coming first, and then the cross-border release coming second, because under our approach, we want—the cross-border release is really the capstone to all of our regulatory proposals. It kind of looks back over all of them and asks the question, how will these apply to cross-border transactions? And so it really is important that we have all of our proposals done and then do the cross-border release.

That is in part an answer to your second question, which is why would we do it as rules? We are in some cases amending some of the rules that we have already proposed and providing fairly significant guidance about how the rules would apply in a cross-border context where we feel that it is beyond the scope of what we can do by interpretation.

The question of whether you do something by interpretation or rule is a judgment that each agency has to make. We have different statutes and so we have different words that we are trying to interpret in some cases. But our approach so far at a staff level, and the Commission has not yet addressed this issue, is that we will need to do that through a rulemaking that adds to what is in the statute within the scope of our authority, and also that will incorporate full economic analysis and a cost benefit analysis that normally would accompany a regular rulemaking.

Chairwoman STABENOW. And when would you anticipate having that done? I mean, when you look going forward, you have about a third of the rules done now. Are we talking the end of the year?

Mr. COOK. We are talking before the end of the year, I would hope. We are hoping to get the capital and margin rule done in the next couple months, meaning finalized in the next couple of months, and then the cross-border release would come right after that. But we are actively working on it now so that we can, as I said, sequence it after capital and margin, but have it done as quickly as possible after that.

Chairwoman STABENOW. Thank you. Senator Roberts.

Senator ROBERTS. In Commissioner O'Malia's statement of dissent regarding the president's fiscal year 2013 budget for the CFTC, he states that the Commission's investment in technology should be its highest priority and that funds for technology should not be redirected for other purposes. My question, Mr. Chairman, have you redirected funds meant to be used for technology, and I stress, was it not a technology update that allowed the self-regulatory administration, the National Futures Association, pardon me, to ultimately catch Mr. Wasendorf at Peregrine?

Mr. GENSLER. From reports, sir, it does appear that they go in every nine to 15 months, and their role is to do audits. And this has moved from a paper process to an electronic process. And you are correct, from the reports we will learn more facts. They are moving to an electronic confirmation platform rather than a paper confirmation platform.

Senator ROBERTS. But have you redirected funds meant to be used for technology? That is my basic question.

Mr. GENSLER. So to that part of your question, I believe actually we have gone the other way. We are an agency just about 10 percent in head count more than we were 20 years ago. We are about 690 people right now. This year we will spend just approximately 50 million on technology, which is significantly up from last year. And in fact, working with Congress, I think they laid out that we must spend at least 45 million.

What we have been able to do over the last several months is redirect more into technology. We need to do both. We need people and machines.

Senator ROBERTS. But have you redirected funds that were designated for technology for other purposes?

Mr. GENSLER. Well, our appropriations said that we had to spend at least 45 in this year, and I think we will be close to 50 million on technology.

Senator ROBERTS. I appreciate that. Let me understand if—or see if I understand this correctly. The CFTC needs a larger budget to regulate a $50 swap in Singapore, because it has a direct and significant connection to U.S. commerce. This requires the CFTC enforcement action on a foreign bank that you are calling a U.S. person based on substituted compliance in interpretative guidance, a document that has no force of law. Where is all of this found in Dodd-Frank?

Mr. GENSLER. Well, in Dodd-Frank, in section 722(d), Congress laid out specifically the jurisdiction of the agency. They did that for the CFTC. There is not a similar provision on the SEC side. We had many, many commenters say, can you help interpret the words? What does it mean to have a direct and significant effect on commerce and activity in the United States?

I am roughly paraphrasing, but that is what 722(d) is.

Senator ROBERTS. All right, let me see——

Mr. GENSLER. But that is what we are trying to interpret, sir.

Senator ROBERTS. If I might, what if this U.S. person disagrees that it is a U.S. person based on this interpretative guidance that you admit has no force of law; what happens then?

Mr. GENSLER. Well, we are trying to—the statute is very clear, black letter words, and we are helping give guidance and we have actually put it out to notice and comment. We are going to take public comment, and I think benefit from consultation with the public before we finalize such a guidance.

Senator ROBERTS. Well, if we have letters from five international regulatory agencies saying thanks, but no thanks, we are not a U.S. person, does this still make the U.S. vulnerable to retaliatory regulation or regulatory arbitrage?

Mr. GENSLER. Well, if somebody is not a U.S. person under the guidance under the law, then it is not under our jurisdiction. What we do have is JPMorgan Chase which just lost several billion, $5 billion in London, and that became a U.S. issue. AIG, if I can say, was very much a U.S. issue, even though they ran their derivatives portfolio out of Mayfair, London, and $180 billion of U.S. taxpayer money went into AIG at $600 for each of us.

Senator ROBERTS. I understand that problem, and it is a very serious problem. But what happens when the foreign regulations are not similar to U.S. regulations? Which regulation supersedes the others? Who will decide if there is a disagreement?

Mr. GENSLER. Well, what we have said is if they are comparable and comprehensive, which are words that have been used for actually more than a decade probably, then we will defer under something called substituted compliance. But if U.S. taxpayers are left exposed because a U.S. bank is operating in London, Dodd-Frank would still be applicable in that situation.

Senator ROBERTS. About a year ago I asked you if a Sumner County, Kansas grain elevator would have to change his sign to read swap dealer. A year later we now have five different definitions for a bona fide hedge. Why can't we just have one definition? We have five.

Mr. GENSLER. Well, the good news is that Sumner County grain elevator operator will not have to be a swap dealer under our completed rules.

Senator ROBERTS. I appreciate that.

Mr. GENSLER. And that is very important. Why we have different definitions is in the circumstance of end users and their choice not to clear, I think Congress was very direct with us. Make it easy. Make sure that all these non-financial end users do not have to clear, and I think that is what we did last week when we finalized the rule.

But then in another circumstance, for instance the Volcker Rule, there is different language about hedging, and I think Congress did not want the hedge exemption to swallow the limitation on proprietary trading, so different circumstances and congressional intent.

Senator ROBERTS. Where are the CFTC's recommendations regarding the MF Global fiasco? We had the second major failure we just talked about this week. Do you have those recommendations?

Mr. GENSLER. Recommendations are in front of commissioners now. Some of the recommendations were embodied in the good work with the NFA and the CME and the futures industry, that was finalized last week.

Senator ROBERTS. Mr. Cook, the CFTC has already proposed an interpretative guidance. Your testimony indicates the SEC intends to propose an administrative rule. You are also doing a cost benefit analysis. The CFTC is not. It is my understanding the two agencies will somehow merge these into a single proposal coming later; is this correct?

Mr. COOK. It is correct that we would do a—we intend to do a series of rules.

Senator ROBERTS. You are a lawyer. How does this work? How long will it take?

Mr. COOK. Well, we are not going to merge our rules into a single rule. We will, when we propose our rule, take into account what the CFTC has done and obviously, one of the things we have to do when we do a cost benefit analysis is consider whether if we are being different than another regulator where the markets overlap, what are the costs and what are the benefits for doing that.

Senator ROBERTS. Are you saying the CFTC sees it one way and the SEC sees it another, and when the public gets a chance to comment they will ultimately see it the SEC's way?

Mr. COOK. No, sir. I did not mean to suggest that. We have not come out with our proposal yet and so it will be informed by what the CFTC has done. It may, in many respects, look like it. It may look different in certain respects, all of which we would request comment on.

Senator ROBERTS. So you believe the SEC is doing this correctly?

Mr. COOK. I believe we are trying to do our best to implement faithfully the statute and consistent with our organic documents, which require us to follow certain administrative procedures.

Senator ROBERTS. Mr. Gensler, how about you? Do you also believe the CFTC is doing this correctly?

Chairwoman STABENOW. And please be brief. I am going to wrap up.

Mr. GENSLER. I do, sir. I do. May I just clarify something? About this transfer of technology, we spent a little over 37 million last year. This year I think we will be close to 50. There was discussions with Congress as to how much we should spend this year. The appropriations bill ultimately ended up at 55 million, but then said it could be brought down to 45 by something technically called transfer authority. So we did that, but we are spending approximately 50.

Chairwoman STABENOW. Okay, thank you. Yes. Thank you very much. Senator Harkin.

Senator HARKIN. Thank you, Madam Chair. Mr. Gensler, you have already covered a little bit about Peregrine Financial that went under in Iowa, over $200 million shortfall in customer segregated accounts.

First of all, I find it hard to believe, hard to believe that one person with hundreds of employees dealing with all these accounts could be the sole person responsible for this. I just find that hard to believe, and I hope the investigations will continue on to find out if there were others involved.

Secondly, the controlling agency, that was the National Futures Association, not you, not the CFTC, the National Futures Association. I am astounded that this could go on for nearly two decades, and yet nobody checked to see where these bank statements were going, who they were going to, if they were real or not.

I am just—I find that mind boggling, that no one at NFA could discern this, which raises again a question in my mind about this whole issue of self-regulation. You know, self-regulation only works if you have really tight controls from the regulatory body over them, which would be you, the CFTC. So I guess picking up on this Peregrine debacle, if the CFTC has direct access to bank records on customer funds, if you do that, you have the resources to actually—and the personnel to do an adequate job of oversight then?

Mr. GENSLER: We do not, frankly. We do not—we are only about 10 percent greater than we were 20 years ago, and the futures market alone is five-fold bigger, and then we have the swaps market that is vast, eight-fold more than that five-fold. But I do think direct electronic access for the self-regulatory function and for us is critical. But the first line of defense still will be the self-regulatory organizations.

Senator HARKIN. As I said, I am losing faith in self-regulation, unless there is adequate, tight oversight by the agencies that we fund through the Federal Government and through the regulatory process through what you can do to make sure that they are doing their job.

We have seen self-regulation fail since Glass-Steagall was overturned in 1999. I had the Federal Reserve chairman here telling me that oh, yeah, they are going to self-regulate themselves. Well, we found that that did not work either. But so you have to have the personnel and the resources to be able to adequately oversee the National Futures Association.

Mr. GENSLER. We do, and I think we all——

Senator HARKIN. But you——

Mr. GENSLER. We absolutely do need those resources the President put forward, $308 million budget.

Senator HARKIN. Well, let me ask you this. The House Appropriations Committee just cut the funding by $25 million. How is that going to help you? How is that going to help reassure the public that the CFTC is going to have oversight and adequate regulatory oversight over the NFA and other entities?

Mr. GENSLER. I think there would be more mayhem in the markets.

Senator HARKIN. Well, that is what is happening. They are trying to cut this down, say well, they will just take care of themselves. We have seen what has happened on that in the past.

I wanted to get in just briefly on the swaps issue that my friend from Kansas raised in terms of overseas. Dodd-Frank does say, and I quote, that U.S. regulators can oversee swap activities that quote, have a direct and significant connection with activities and/or effect on commerce of the United States. You mentioned that there.

Well, I am concerned that without the proper regulatory framework, here we go again, the proper regulatory framework, that large U.S. swap dealers will move their swaps business to a subsidiary overseas, evade CFTC oversight while retaining the financial risk in the parent U.S.-based company. In other words, U.S. taxpayers will still bear the risk.

So I ask you, Chairman Gensler, did the trades conducted by JPMorgan's chief investment officer in London, about $7 billion that you mentioned, did it have a direct and significant effect on commerce in the United States? If so—yes?

Mr. GENSLER. Absolutely. Yes.

Senator HARKIN. Well then, going forward, how will the Commission ensure that U.S. taxpayers are protected for swaps conducted overseas, but for which financial risk is held in the United States?

Mr. GENSLER. What we laid out in this legal interpretation of the statute that Congress wrote is that it is a branch of a U.S. person overseas that is covered by Dodd-Frank. If it is guaranteed by the mother ship back here so that risk can come back here, that comes under Dodd-Frank. But we could look to substitute a compliance and so forth.

But these risks do come crashing back here. I used to work at a large financial institution. We set up hundreds of legal entities. Today I understand they set up thousands of legal entities around the globe. But in a crisis, the risk comes crashing back here.

Senator HARKIN. Mr. Gensler, I am worried, and Mr. Cook also, about the integrity of financial markets, especially in the areas of swaps and futures. Here are some troubling events. Goldman Sachs sold a CDO derivative to a client, even though internal e-mails from the bank labeled it one blank deal, bad deal. JPMorgan's chief investment office did the $7 billion that we lost in London.

Large financial institutions across the globe are being investigated for fixing the London Interbank Offered Rate, LIBOR, a key benchmark interest rate in trillions of dollars worth of financial transactions. Two futures brokers, MF Global, Peregrine, have recently been found to have significant shortfalls in segregated customer funds.

So when I hear people say that we need to get rid of the reforms of Dodd-Frank, most of which are not even in effect yet, it makes me wonder whether or not people are paying attention to the same things that we read about in the paper. So again, it is high time that we get the regulations out, get the reforms of Dodd-Frank finalized so both of you—when will your commissions get this work done? Mr. Cook?

Mr. COOK. There is a whole series of regulatory requirements under Dodd-Frank to address a range of those issues you raised, sir, including things beyond title VII and whether it is a Volcker Rule or restrictions on asset-backed offerings, and we are trying to tackle all of these in parallel and move them as quickly as possible.

We have a lot of work ahead of us, but we certainly understand the importance of getting it done as quickly as possible, and are trying to prioritize and coordinate effectively in doing so.

Senator ROBERTS. So you cannot give me any time frame. Chairman Gensler, how about——

Mr. GENSLER. We are well over halfway done. You gave us about 55 things to do. We have just under 20 to go, and I think that we will complete most, if not all, by December 31st of this year, but there may be two or three that slide into the first quarter of next year.

Senator HARKIN. Well, good luck in getting it done when you are going to cut $25 million from your budget, but I hope that we do not do that.

Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much, Senator Harkin. Senator Grassley.

Senator GRASSLEY. Thank you, Madam Chairman. Very important hearing. Glad you are having it. I follow along on what Senator Harkin said about Peregrine. I have some of those same questions. I have a little more specific questions, but before I go to those questions, Mr. Gensler, let me say a few things.

It is important that we do flesh out the issues with the implementation of Dodd-Frank. For instance, I continue to be concerned about what sort of reach these regulations will have on agricultural cooperatives, especially given that agricultural cooperatives were by no means responsible for the events that led to financial crisis in the first place.

Our commodity markets are vital for our farmer's businesses, our economy. We must have confidence in our system. Farmers have utilized a commodity trading system for decades to help manage risk, but the confidence of farmers, investors and other market participants is shaken, first MF Global. Now we have Peregrine.

So while we are here today to discuss the development of regulations, we have to also make sure that the regulations we already have in place are being enforced. I know some people will always try to get around regulations, but both MF Global and Peregrine situations cause me concern that perhaps not everything is being done to ensure proper oversight of brokerage firms.

Lead in for my first question. It has been widely reported that the owner of PFGBest was able to defraud regulators by forging bank statements. My first question is two-part, but I will give you both parts of it. Isn't it a cornerstone of independent auditing for auditors to check with banking institutions as to what account balances are? Why were the auditors who were auditing PFGBest not checking with PFGBest Bank during the 20 years this fraud was apparently occurring?

Mr. GENSLER. I appear here as the head of the Commodity Futures Trading Commission, not as an auditor, but I do understand that those are the cornerstones of confirmation by independent CPAs and the National Futures Association, to do that. It appears here, and what we have alleged, is that there was deliberately dishonest and forged bank statements and also fake, what was it called, bank addresses on these statements. That is what we have alleged, and in fact, has been admitted in a note that was left when

Mr. Wasendorf attempted to take his own life. So we need to go back and look at that.

I do think that this failed the investors of Peregrine, but both the independent CPA and the NFA, as we understand it, were well aware of the cornerstones that you mentioned in a paper world. I think we have to go to direct electronic means so that the regulator and the CPAs can get these confirmations and acknowledgment letters.

Senator GRASSLEY. And my second question, we have had customer money go missing in MF Global and Peregrine. What is the CFTC doing to ensure segregated customer money is properly safeguarded? How is the CFTC going to respond to jittery farmers and investors worried about whether their money is properly accounted for at whatever firm it is held?

Mr. GENSLER. We have done significant steps. We need to do more. We have reorganized and stood up a division. We have hired new leadership, not only at the top of the intermediary oversight, but also the examination function, a man who is long time an auditor himself. And we have helped with the NFA and others put in place four or five new commonsense rules. Though I am not—as you know, I am not participating directly in the MF Global situation. We have had some good public comments about that.

We worked through the roundtables. We got public input. Our five commissioners came together and NFA put some new rules in place, and our commissioners now have in front of them a whole set of new rules as well that we will put out to public comment hopefully in the near term.

I do also think we need to do a complete review and get people looking at how we examine the examiners, how we at the CFTC oversee the SRO functions, as Senator Harkin and Senator Roberts also referenced. We have to be reflective and when we are reflective, we might find things over the years that we wish we had done better at the CFTC too, but we should not shy away from that. We have to look at that and really see what can we do better as well.

Senator GRASSLEY. And my last question, do you have any initial impressions or opinions on how the National Futures Association and/or the CFTC missed this fraud by Peregrine over the last 20 years?

Mr. GENSLER. Again, I think we are going to learn a lot more facts. We are going to look at the audit files themselves and see specifically what was NFA looking at, and it is going to be all part of this investigation. And also, we are going to be reviewing ourselves too and having people look at how we examine, as I say, the examiners, how we look at that.

So I look forward to sharing that as we learn more of the facts, because the investors here at Peregrine got let down.

Senator GRASSLEY. I will yield back my time, Madam Chairman.

Chairwoman STABENOW. Thank you very much, Senator Grassley. Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Madam Chairman. Thank you for holding today's oversight hearing. I think we all know that in the last two years since Dodd-Frank was signed into law, there have been far too many stark reminders of the financial crisis of ’08, and the necessary reason to put forth some reform of our regulatory system.

We have seen the collapse of MF Global, which left those the system was supposed to protect holding the bag, many in my state who are still working to collect the money, and had a devastating impact on the livelihoods and savings of so many people. And I understand we are going to have a hearing on that August 1st, so I will explore more what is happening with that at that time.

More recently, as we have discussed, the JPMorgan trading loss, Barclays’ admission to manipulating the LIBOR rate, and now last week Peregrine Financial Group filed for bankruptcy after its founder blatantly defrauded its customers out of hundreds of millions of dollars.

It seems that there is more work to be done, and that is what I wanted to focus on. I know that you discussed with some of my colleagues, Chairman Gensler, the emergency industry meeting set for next week to explore how to better protect customer money in light of what happened at PFG. And it just seems so unbelievable that it is just nine months after MF Global, especially when you look at the timeline, and as my colleagues from Iowa pointed out, the simplicity of how this fraud was perpetrated.

What assurance do you have that we can address this going forward? And my specific question is, I know you were pushing them to do electronic filings, so do you have that power now and it is just that it has not been rolled out? Can you require all of these firms to do electronic filings, and what other ideas do you have?

Mr. GENSLER. We do think we have the authority, but we have to do it through notice and comment and the administrative procedures, put a rule out, take comment. But we do think that we have that authority and we look forward to doing that. In terms of beyond that, I also believe that investors should get the same transparency into their accounts in the futures world that they have come to expect in the securities world and the mutual fund area, that if I have a futures account somewhere, that if I choose to, can know how is it invested, and so forth. We have raised that with industry. If we have the support to put it out to public comment, we will do that.

I think there needs to be a strengthening of the internal controls of futures commission merchants and it will be all weighed against cost and benefits, of course, but higher internal controls at these futures commission merchants, particularly the separation of duties, separations of duties of the people that can move money from those who can count the money. This is a classic separation of duties issue.

Senator KLOBUCHAR. Just to give you a sense of one Minnesotan that we have already heard from on Peregrine. And he copied me on the letter that he sent to the NFA. And this guy had his money with MF Global, then he lost money on that, and then he went over to Peregrine, which I think we are going to find of many mid-western farmers, to try to protect himself.

This is what he said to the NFA. He said, the problem with your statement is the implication—a statement by the NFA—the problem with your statement is the implication that failure to detect a $200 million fraud earlier should not count against you. It just matters that you catch it. I could not disagree more. Your job is to prevent fraud by putting in place the tools and people to ensure that funds are as reported, that segregated balances are protected, and that people making investment decisions can rely on the audits that you perform.

Why have there been so many recent cases where the system has failed to detect the risk and again, can you commit here that we are going to be able to fix this?

Mr. GENSLER. Senator, I find myself agreeing with your constituent who wrote that letter. We have to do better. I think we all do, at the NFA and the self-regulatory functions, but also how we examine the examiners. There are certainly funding issues as well, but I think it is really about how the audits and examination function occurs on the street.

Senator KLOBUCHAR. And I know I have heard you talking to some of the other senators about reaching out to the banks where future firms held cash, to seek to obtain independent verification that the statements made by the firms are accurate, which I think would have helped to catch the Peregrine problem earlier.

Obviously, you were not chairman when this started, this particular fraud. But I just wonder why this decision was not made back in January to rely on information maintained by the FCMs instead of confirming balances directly with depositories holding customer funds.

Mr. GENSLER. Again, we will learn a lot more facts, but as we understand it, there is Photoshopped or purposefully forged documents and even a fake P.O. Box for the bank. What we understand is the NFA last did their audit in May of 2011, February of 2010. The independent CPA last did one for December 31, 2011. All of them were in essence defrauded and lied to, and as I say, we are going to take a look, very close look at each of those, and go back as many years as the documents exist, and also look at what the CFTC did, and what we need to change.

Senator KLOBUCHAR. You think the NFA is up to the task of serving as the first-line regulator here? Obviously, we are getting letters like the one I just received that make people think they are not ready for this.

Mr. GENSLER. You raise an excellent question, and in fact, I will say to this Committee, we are broadening it with the swaps reform of Dodd-Frank, because under Dodd-Frank, the NFA will be the frontline regulator of swaps dealers, ranging from the J.P. Morgans of the world across any swap dealers. No agricultural cooperatives, by the way, will be swap dealers though. We did address that. I want to make sure we understand that.

So we are adding a self-regulatory function to the NFA. It is in our statute the way Congress has laid it out. We rely on them and then we are supposed to oversee them. So you raise an excellent question. I think that all of us have to do better, and we are going to review the NFA self-regulatory responsibilities.

Senator KLOBUCHAR. Okay, thanks. And one last question. You mentioned the end user issue, and I thank you for your work on that issue with many of the end users in my state. And you mentioned in your testimony that 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.

As I know you are aware, the rule proposed by the Prudential regulators has caused a great deal of concern among end users, as it would explicitly require swap dealers and major swap participants to collect initial and variation margin from non-financial end users under certain circumstances. Could you talk about your efforts to align these requirements both here and abroad and where things stand with the Prudential regulators?

Chairwoman STABENOW. And I would ask you to do that quickly. Thanks.

Senator KLOBUCHAR. Because it was such an easy question.

Mr. GENSLER. We have made great progress, and we put out an approach to margin which actually, I believe, is consistent with what the CFTC had done, and this document only went out about a week and a half ago and is out for two months of further comment. So I think that the Prudential regulators understand what——

Senator KLOBUCHAR. Okay, and Chairman Stabenow, I will simply ask a follow-up question in writing to the chairman about this matter. Thank you.

Chairwoman STABENOW. Absolutely. Thank you very much. Senator Thune.

Senator THUNE. Thank you, Madam Chair, thank you, distinguished Ranking Member, for holding this hearing. It is important. It is timely. I want to kind of follow-up a little bit.

I am sorry I walked in a little bit as the senator from Minnesota was asking questions, but I am just curious to know from the standpoint of the average investor out there, when the meltdown occurred in 2008, we enacted these reforms. Dodd-Frank was supposed to make sure that investors were protected, that these types of things that have been done in the past would be prevented from happening again.

And if you are an average investor or an end user, what kind of—this is sort of a global question from 30,000 feet—how would you reassure that person out there after you had MF Global and Peregrine now, and then, of course, what is happening with JPMorgan Chase, those are like sort of major, big, significant events that I think cause people to question, doubt, and really impact the confidence that the American people have that there are safeguards in place that are going to protect them.

I mean, how do you respond to them in light of the fact that Dodd-Frank was supposed to address this issue of systemic risk and get us away from the concerns and the doubts and the questions, that the lack of confidence that the American people have that it is a—financial system is working and working with integrity?

Mr. GENSLER. And Senator, I would certainly add to that, this recent matter with Barclays and LIBOR, which was not——

Senator THUNE. Right. Exactly.

Mr. GENSLER. —which was not an honest reporting and not with integrity in essence. I would say that this is midstream. This is very much a work in progress. Dodd-Frank is historic. I think it is really critical that we get it in place. We have not been trying to rush it against the clock though. We have been trying to get it balanced with cost benefit analyses and so forth.

But it is time to get it done. I think that we still have much work to do at the CFTC, both in the futures and in the swaps area. There is going to be greater transparency starting this fall, that the public will see these transactions in the swaps markets.

We have greater customer protections. But just as Peregrine's circumstance showed when somebody attempted to rob the bank basically, I mean, this was like a bank robber with falsifying statements and taking $200 million approximately. We have to do everything we can to ensure that is harder to do, it is harder to defraud. Because human nature, there is always going to be somebody out there who is looking to defraud. You have to make it harder and have enough cops on the beat to go after them.

Senator THUNE. Do you think that you—you are confident the Commission has the types of safeguards in place?

Mr. GENSLER. I think we are getting there. I think that in terms of the swaps markets reform, we are not fully there. We have close to 20 rules to continue to implement. We need to continue to work with industry to make sure that it smoothly is implemented, that it is not, as Senator Roberts was concerned, and I agree with him, that it is not like a gotcha moment on October 1st, but that it smoothly is put in place.

So I think there is a lot more to do here. And in the customer protection area, just as this Peregrine situation highlights, I think it is critical that regulators have direct access and can see these accounts.

Senator THUNE. Let me ask a question, because a lot of this comes back to use of segregated customer accounts, and that is where the Volcker Rule would apply. But I would like to ask you, I guess, how you would distinguish between proprietary trading and hedging, which again, I think is the crux of the Volcker Rule, and whether or not you believe you can draw a clear distinction between proprietary trading and what constitutes a proper hedge, and if so, how would you make that distinction?

Mr. GENSLER. Senator, I think it is one of the most challenging rules that you gave, Congress gave the federal regulators, prohibit proprietary trading so the taxpayers do not stand behind sort of just betting on the markets, but permit, as you say, hedging and market making as well, which are really critical.

It is critical that banks hedge themselves. We are making very good progress, but it is very challenging, because they overlap.

Senator THUNE. What about portfolio hedging, is that something that ought be allowed under the Volcker Rule?

Mr. GENSLER. Well, Congress actually spoke to it and said that it applies to hedges for specific risks or aggregate positions. I think that should be allowed. Congress answered that question. This word portfolio hedging can sometimes mean almost anything to anybody.

If it is tied to specific positions, even if there are a 100 of them and it is tied to specific positions, I think Congress spoke to that and it should be allowed, but not if it is just something that has a label, but is really betting on markets.

Senator THUNE. Let me ask to the whole question of how the SEC and the CFTC interact with regard to capital and margin requirements. I mean, the Commission initially said it would recognize the SEC's capital and margin requirements and CFTC has now indicated it will not. Where in the Dodd-Frank Act is this distinction made?

Mr. GENSLER. Well, for Futures Commission Merchants, they are often also registered as Broker-Dealers, and so when there are a joint Broker-Dealer and Futures Commission Merchant, we have joint rules on capital that have been in place for numerous years, and we continue to share our work with them for the non-joint registrants.

But I think that we would set the margin for somebody who is not a broker-dealer, but is just under our jurisdiction, and obviously they would be similar. But maybe Mr. Cook has something——

Mr. COOK. I think that is right. I think—and one of the proposals was to recognize for certain capital purposes the use of models or evaluation at risk regime, and I think there was in the CFTC proposal, and Chairman Gensler can correct me, there was some recognition if the SEC had approved a model that the CFTC would accept that. And I think that is part of an overall regime where we are trying to recognize where other regulators have already addressed a particular framework for capital and risk management. It is something we are considering on our end as well.

Mr. GENSLER. Particularly since we are thin-staffed, we are glad to recognize models that they approved.

Senator THUNE. I see my time has expired. Thanks. Thanks, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator Lugar.

Senator LUGAR. Thank you, Madam Chairman. I remember vividly a hearing that Senator Harkin conducted four years ago. It was at the time of mortgage crisis, and this oversimplifies the explanation we were given, but a gentleman from the Federal Government said that you must understand this way, that bankers, young bankers out in the neighborhoods are determined to get as many mortgages as possible. They even get bonuses regardless of whether the borrower can pay it back.

Because the bank then packages all of these mortgages, sends it on to a larger bank, has no risk left. The larger bank packages some more and some bigger packages finally arrive at locations where financial institutions, realizing they have quite a bag full now, and the risks are such, try to devise formulas, maybe from one to 10. Some are very risky and some are less and they then produce securities, which have lots of risk attached, or less as the case may be, and they try to market those, often successfully, and those who buy the riskiest ones want insurance.

They go to a firm such as AIG, was mentioned specifically in those days. AIG then has a whole raft of these situations, and they offer insurance, but the testifiers to the offerer also bets, or opinions, and says what's this all about? Well, for example, somebody at AIG might decide that a security in Pakistan was the one that they wanted to have a tradeoff, swap, or what have you with, and so they go into this sort of situation.

Now, I mention all of this because it was at least a reasonable way to explain to my constituents why disaster had occurred along the way and why AIG finally had to be rescued itself from all of these machinations. And we had then descriptions of very able guys back in the backroom trying to make money for their banks or for their institutions with all sorts of extraordinary trades. And people said this is the American enterprise system, this is freedom of choice to use your money however you want to.

The dilemma was that the American public was left with the recession and all the tragedies that have come from all of this. So this led to Dodd-Frank and led to other things prior to that point. Now even as you have testified, Mr. Gensler, over the years, we always keep raising the question, and you have raised it tactfully today, how are all these regulations ever going to be written with the staff that you have, or with—how in the world can CFTC or other regulatory, maybe SEC too, but we have been dealing with—and the answer never really comes through because there seems to be a tension between some who are risk takers in our system and who we admire and people who do not really want regulation. And the tensions finally come down to the fact that if you do not have many rule makers over at CFTC, there probably is going to be less regulations.

So if we pass Dodd-Frank and two years later we are out asking you where are all the rules, and you are saying well, you have to go through this public notice and all the rest of it, even then I would be curious how you run the agency. Why don't you have people sitting around the table and say, now today we are going to make a decision, we are going to have a vote, we are going to move this thing along?

But leaving that aside, it just seems to me we keep talking past the issue. On the one hand, we know these risks occur, these tragedies we have discussed today. On the other hand, we seem very reticent to do rulemaking or to have transparency with swaps, for example, or transparency with a lot of things, for fear this is an invasion of privacy and a curtailment of American free enterprise.

I lay all this out because I am wondering how, with 30 rules done, or 25 to go or so forth, how there is any assurance the American public—and in the meanwhile, more tragedies are not going to occur that jeopardize banks, and then get back to the argument of too big to fail. In other words, if an agency or a entity makes mistakes, do they fail and take everybody with them, or is there a public assurance they are going to be rescued?

When you advocate before congressional committees for more staff, why aren't you successful? What do you see as the barriers right now? Why don't you make the rules? Why don't you get on with it much more rapidly?

Mr. GENSLER. These are excellent questions. I have three daughters and when they ask for the car keys, I am glad that there are actually commonsense rules of the road and there are traffic lights and there are cops on the road to protect my daughters from drunk driving, and I think that is what the American public wants in the financial markets as well, commonsense rules, but still let you get to where you need to go.

Innovation and risk in the economy are there. It is a great backbone of our American success is that people can innovate. In terms of the head winds we have, they are very significant. Congress asked us to write nearly 60 rules. We have gotten 33,000 comment letters. We have had 1,700 meetings, 18 full roundtables. In my written testimony I say we are going to have another roundtable on customer protection. We have two lawsuits already, and it is our American way, and we are going to vigorously defend them and if we got them wrong and a court says we got them wrong, we will have to go back and do them again.

But I think that the American public needs us to finish these rules. They need—I believe it is a good investment to have the CFTC have more cops on the beat in essence, like my daughters would like, so that we protect the roads from the drunk drivers.

Senator LUGAR. Well, can we protect the Volcker Rule? Inside the few seconds left, the one Paul Volcker was really talking about, the fact that as a depositor in my local bank, I do not really want the bankers speculating with my money, even if they can make more money on it. We try to separate these functions. Is this going to work in real life, or are people going to continue to protest that depositor money, or whatever you want to call it, is really up for grabs? Can you get that part of it at least safe?

Mr. GENSLER. I think it is a real challenge, Senator. I think there will still be risks in banks. Nobody is going to repeal the risk in banks. I think the banks need to have a freedom to fail and when they fail the taxpayers do not bail them out.

Senator LUGAR. Thank you. Thank you, Madam Chairman.

Chairwoman STABENOW. Thank you very much, Senator Lugar. Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair. I agree with Senator Harkin in the sense that we certainly need to provide you with the adequate resources that you need to carry forth with the agency and provide oversight. I guess the question is is perhaps a lot of people are concerned that you have mission creep and have creeped over into a lot of areas with duplicative entities.

Sometimes not really having the authority that Dodd-Frank gave you, I think you have used the term in the spirit of Dodd-Frank, whatever. But I think an example of that might be that the CFTC has in their definition of swaps dual registration and things. Essentially you are going to have an additional 18,000 to 28,000 registrations to be audited by the CFTC despite having regulated—many of those being regulated by other agencies.

With the problems that we have had with situations where people have lost a vast amount of money and the regulation has not been there, wouldn't you be better off concentrating on the core role of the agency right now and getting that under control?

Mr. GENSLER. Senator, we are very much focused on the core role and mission to oversee the derivatives market. Of course, Congress added this vast market swaps that is eight times the size. But I will use just this LIBOR situation. CFTC opens an investigation in 2008, April, to look at a key benchmark where market regulator—there were bank regulators, of course, around the globe. But we as a market regulator we knew it was critical. Over 70 percent of the futures markets priced off of Eurodollars, by the way, off of this LIBOR rate.

It took us four years. It is a very complex case, but we are very much focused on the core mission. That is very core to the futures marketplace, even before Dodd-Frank. Now, of course, we are also focused very much on what Congress asked us to do to protect the public for the unregulated swaps marketplace that existed in 2008.

Senator BOOZMAN. Let me ask both of you. Are you doing a better job of working together and trying to come up with regulations that are in harmony with each other and not regulations that makes it difficult as those that follow the regulations, for them to really feel like perhaps one agency is going one way and the other agency is going another? Mr. Cook?

Mr. COOK. Thank you, sir. I think we are working hard to do that, but in the spirit of the need for regulators to be self-critical, I think the jury is still out, because we have not really finalized our rules yet. While I think if you look over the rules, there are vast swaths of similarities or identical aspects of what we proposed.

There are some important distinctions, and I think we need to keep those in mind as we move to the adoption phase. And if it is different, we need to be able to justify it based on some rationale, like a different market. There are some differences between the markets we regulate. There are some differences on our statutes, and I think we need to take a very careful look at that as we move forward.

Senator BOOZMAN. Your roll out is different than the other agencies' roll out. Can you tell us why you chose to roll it out in the way that you did as opposed to piecemealing it?

Mr. COOK. We made a choice early on that we wanted to delay the effectiveness of the substantive requirements, and so none of our substantive rules were triggered by the recent adoption of the product definitions because we were not sure when that was going to happen and where we would be in the process. At that time, we decided that we were going to—each time we adopt a rule, consider when it should go live, and then wanting to kind of look back at the whole mosaic of the rules and see how they fit together and give people an opportunity to see how we think of sequencing them, and then to consider how to comment on that.

That is the policy statement that I mentioned in my opening remarks that we have put out as a way to kind of help inform that debate.

Senator BOOZMAN. Very good. Chairman, you have taken a little different view of that in your roll out. Will you comment on that, and then again, a comment on how things are going in working with the SEC in trying to get these things accomplished?

One of the problems that we have, and you guys know this so well, better than anybody, but when there is uncertainty, and there is uncertainty in this area, there is uncertainty throughout our entire economy. It is such a drag on the economy, and so if you would comment, that would be great.

Mr. GENSLER. I think we are working very well with the SEC, with Chairman Schapiro and myself forming a partnership, but it is not just the Chairman. It is the staff really. It may have been a low bar, but there were rules that Congress asked the two agencies to do back in 2000 that were not done when each of us got here eight, nine, 10 years later, and yet we have just completed two very important foundational rules jointly with the SEC.

I know that was a low bar, but we are doing so much better. In terms of moving forward, Congress gave us oversight to what is approximately 95 percent of the overall swaps market, just measured in notional side. The interest rate swaps market, the energy swaps and agricultural swaps are smaller, and then also the indices for credit default swaps.

That is kind of the things we got. They got a lot of other things to do that Congress gave them to do. So in fairness to the SEC, they have such a full plate on other things. We are just swimming in one very deep lane called futures and swaps, and so that is partly why we have taken another approach. We have gotten so much completed. They have gotten many things completed in other lanes, not derivatives lanes.

Senator BOOZMAN. Your approach is being received——

Mr. GENSLER. Well, our approach——

Senator BOOZMAN. —positively from the industry?

Mr. GENSLER. Well, our approach is is that we finished our proposal phase of about 55 proposals by about a year ago, and then we opened them all up to public comment again, or mostly all of them. Then we turned the corner and started finalizing rules about a year ago. We have finalized 35 of them. Many of them will now be implemented. Also, we are living within the President's commitment to the G–20 nation leaders that said we would complete this by December 31, 2012. Congress said to get the job done within one year of Dodd-Frank, and now it is two years.

But again, we are in one very deep lane and the SEC is in many other lanes, so that is why we actually had the luxury to further along on our job.

Senator BOOZMAN. Thank you all. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much. Chairman Gensler, I would like to talk a little bit more about LIBOR, and appreciate the recent enforcement actions against Barclays, and there is no question that this rate manipulation scandal is very significant, implications of hundreds of trillions of dollars in transactions, and it really casts another dark cloud over the financial industry. Are you working on similar cases related to LIBOR?

Mr. GENSLER. I would not want to compromise other enforcement matters, but I would say that numerous other financial institutions have publicly reported that the CFTC has been asking them questions. So if that——

Chairwoman STABENOW. Could you speak to again the length of time it has taken, because I think it is hard from a public standpoint for people to understand you began this in 2008? What took so long?

Mr. GENSLER. They are very complex cases. We started in April of 2008 and started just actually reviewing the markets and reaching out. I arrived in the spring of 2009, so I remember this one pretty well and got involved. Wonderful staff.

Evidence starts to populate by late '09 and early 2010, and we get the Justice Department and the Financial Services Authority, I think, open formally their case in England in the spring of 2010. So that is already almost two years.

What happens in a case like this, there are millions of documents. Information requests have to be handled jurisdictionally overseas, and so even sometimes to schedule what is called interviews over there—sometimes we call them depositions here—takes a considerable amount of time.

This case was pervasive. It involved trading desks on three continents. It involved two key rates, LIBOR and Euribor. It involved at least four other banks that we name as Bank A, B, C and D in the order, aiding and abetting, what other people might call a collusion, but under our statute, is aiding and abetting, and this management directive where management was saying stay below the parapet, let's get in the pack over a 14 or 15-month period.

So it is a very important case and we focused resources on it. I would also say we have far fewer people on our LIBOR Barclays team than are sitting at this table right now. So it starts—we have 400 different investigations going on at a particular time at the CFTC.

Chairwoman STABENOW. Well, when you look at terms of the settlement, you have laid out parameters for rate setting that seemed to dictate standards that bring integrity back into the process, firewalls, transition, base submissions. I am wondering, when you talk about the broader global lending implications, certainly of which there are many, did you work with the Fed? Did you work with international banking authorities on prescribing standards? How did you approach this?

Mr. GENSLER. We worked with other law enforcement agencies. When we pursue a law enforcement action like this, we work with law enforcement agencies and really try to keep the parameters within that community, because it protects the enforcement floor and does not compromise that enforcement effort.

But I thank you for raising the undertakings. We thought Barclays really needed to do this better. This has to be an honest rate, and Barclays is committed to make it transaction focused based on real transactions that Barclays entered into, and make adjustments if need be as provided in the order. Firewalls and other provisions that are critical, because what they were doing was so pervasive, and it was wrong.

Chairwoman STABENOW. Let me talk a little bit more about international harmonization and global coordination of financial market regulation. It really is a balance on the one hand. We want to make sure we keep this very important industry in the United States and at the same time, there are broad—we are in a global marketplace and so there are broad implications. So I know that there are some very important things to look at on both sides here.

I am glad that you have proposed guidance on the matter, but I have some questions. First, I guess, for both of you, what sort of coordination are you doing with the SEC? I would ask Mr. Cook vice versa in terms of this whole question of the global marketplace and international harmonization.

Mr. GENSLER. We shared with the SEC, the Federal Reserve, the Treasury, the other regulators, not only our draft document before we put it out, but we started about a year ago, in consultation with the SEC, and by about six or eight months ago with the Treasury Department, particularly their group of international folks at Treasury, got a lot of feedback from both the SEC and Treasury on our guidance.

Chairwoman STABENOW. Mr. Cook, you want to respond to that coordination issue?

Mr. COOK. Yes. We have consulted extensively with the CFTC staff. I think as we move forward with our proposal, and as they consider comments on theirs, I fully anticipate we will continue to do so. We have also been partnering up in the international dialog through some of the international organizations, the FSB, the ISCO.

But working groups in that area, but also some other multi-lateral conversations, including at least two meetings of regulators in key jurisdictions, have been attended by the senior leadership of the agencies and agencies from around the world to talk about the timing, you know, what the substance is of the regulations and to further seek to harmonize the end result.

Chairwoman STABENOW. Chairman Gensler, as you look at regulating branches of U.S. institutions abroad at the transactional level, could you speak to the concerns? I know that there is significant competitive disadvantage with U.S. entities versus foreign competitors, so how do we balance that with certainly protecting American consumers and American investors?

Mr. GENSLER. If we were to adopt fully what some in the industry have asked for, the jobs would move offshore and the risk would still be back here. Let me say that again. If we do not cover the branches of JPMorgan Chase and Citibank and Bank of America that do a lot of this business in branches, and the guaranteed affiliates of the Goldman Sachs and the Morgan Stanleys, they would not be covered by Dodd-Frank.

The risk is still the American taxpayers. The jobs and the markets will move to London and elsewhere, because they will go to where they can have less regulation. I used to do a bit of this when I was at one of those firms. It is natural. It is basically just planning, and they have thousands of legal entities now to pick from.

So we are taking into consideration how to best protect the American public foremost, and to comply with Dodd-Frank.

Chairwoman STABENOW. Thank you very much. Senator Roberts.

Senator ROBERTS. One of the things I think is obvious is that, as Senator Lugar pointed out, the need for transparency and cooperation. Just as a question to the chairman, when did the commissioners, or have the commissioners received your recommendations on MF Global?

Mr. GENSLER. As I am not participating in the MF Global matter. I assume your question is more broadly about customer protection. Starting with the roundtables that we had in February, staff under the Division of Swap and Intermediary Oversight——

Senator ROBERTS. No, I mean your specific recommendations, your plan for MF Global. After it is wrapped up, they did the investigation by the FBI and all the rest of the folks that are involved in it at the trustee. But you indicated you were a non-participant, but then you said you wanted to be in control. I am assuming that you have a plan for MF Global, or at least a plan to go forward. Have you shared that with the commissioners?

Mr. GENSLER. Again, I am not participating directly in MF Global. In terms of customer protection initiatives, those have been shared throughout this process from January to now, even leading to what was approved last week from the National Futures Associations.

Senator ROBERTS. All right, here is what I am getting at. You have said before that the commissioners have received, or were being—working on recommendations, sharing things on recommendations. When did they get a copy or the final product in regards to your recommendations?

Mr. GENSLER. The product is actually not yet finalized. It started in January and February with staff briefings, lists of possible alternatives. A lot of that led to what the NFA adopted.

Senator ROBERTS. You did not give the commissioners at 6:00 last night a copy of your recommendations?

Mr. GENSLER. What they received yesterday is still a draft of rule text, which is rule text——

Senator ROBERTS. So they received a draft?

Mr. GENSLER. That is correct. That is correct.

Senator ROBERTS. It is a draft of the recommendations?

Mr. GENSLER. Well, it is actually a draft of rule text that we moved from lists of recommendations, a PowerPoint presentation.

Senator ROBERTS. That was the——

Mr. GENSLER. I do not know the exact time, but yes, a draft of the rule text, yes.

Senator ROBERTS. All right, we are sort of dancing around a pin here in terms of cooperation and to at least letting your commissioners know what the heck is going on.

Why did the CFTC choose to address the cross-border issue via a guidance rather than through a formal rulemaking process? The obvious follow-up is, was that so you could avoid a cost benefit analysis that the SEC is doing?

I think you have sort of indicating that you are trying to direct this or to push this from the CFTC standpoint so that the SEC would follow when it comes to defining the overseas reach of the U.S. derivatives regulation. That was a speech. You can respond to it any way you can.

Mr. GENSLER. Okay. There is actually a specific provision in Dodd-Frank, which is 722(d), which is not also over in the SEC. I do not know the history and the legislative history of why we have it and they do not, but we do. We've got a lot of questions——

Senator ROBERTS. I am concerned——

Mr. GENSLER. We got a lot of—I am sorry, Senator.

Senator ROBERTS. I am just concerned that what has been described as your intergalactic plan, that nobody other than you knows what it actually is, and it could be taking our derivatives markets over a cliff. I just—we know what the SEC is doing. They have a plan.

My question is, what is your plan? For example, how many swap execution facilities do we have operational? Those are the entities that are up and running today that can do the job.

Mr. GENSLER. Swap execution facilities have yet to register. We estimate that there may be somewhere close to 20, but we do not know yet how many will be, and we have not finalized those rules.

Senator ROBERTS. It is my understanding there is only one that is up and operational.

Mr. GENSLER. I am sorry.

Senator ROBERTS. Is that correct?

Mr. GENSLER. Swap execution facilities, there are not any yet. We have not finalized the rules. But if you are referencing swap data repositories, possibly there is just one. There are four others that have various stages of application to become swap data repositories.

Senator ROBERTS. Mr. Cook, can you confirm—you have already indicated that the SEC will be issuing its own cross-border proposal; is that true?

Mr. COOK. Yes, sir.

Senator ROBERTS. Are we going to end up with two separate and distinct cross-border regulations between the SEC and the CFTC when we are through?

Mr. COOK. I think we will have to, as I mentioned, take into account very closely what the CFTC has done and consider whether there are any differences in our markets that might justify a difference in our proposal. I think one of the things we found in some rulemakings, that often proposing alternatives, it is helpful to get good public comment back and inform where we ultimately land. But we have not yet put out our proposal.

Senator ROBERTS. Well, I am worried about the two trains going in a different direction. Why is the CFTC doing it directly? Why don't you have a 60-day clock over at the SEC?

Mr. COOK. We do not——

Senator ROBERTS. They have a 60-day clock. Why don't you have a 60-day clock?

Mr. COOK. I believe the 60-day clock is triggered by the adoption of the products release, and we did—which on the CFTC side, as Chairman Gensler can address if I am wrong, but it triggers the application of certain of those rules.

Senator ROBERTS. Well one is an interpretive guidance and the other one basically is rulemaking that involves a cost benefit study, which CFTC has not done. It just seems to me that you got two different frameworks here.

Is the SEC requiring any registration or even provisional registration be automatically triggered before all of its rules go into effect at the SEC?

Mr. COOK. We are not requiring registration at this point. We have not finalized our registration rules, so none of the rules——

Senator ROBERTS. None of it made the difference. I yield back, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator—let's see here. Where are we? Senator Lugar. Okay. Senator Boozman. All right. Well, given this, at this point we will thank both of you very much. We will continue to work with you and appreciate the opportunities, both formally and informally, as we have been certainly in constant communication with you both directly, but through staff.

There is a lot of work left to be done. We look forward to working with you on it. Thank you very much.

Mr. GENSLER. Thank you again.

Chairwoman STABENOW. We will ask our second panel to come forward. We will return to our five-minute rounds. We will do one five-minute round with our second panel.

[Pause.]

Chairwoman STABENOW. Well, good morning again, and we thank you for your patience and we very much appreciate each of you being here. So let me introduce our panel, and then as you know, we would like you to speak for up to five minutes. Of course, we welcome anything in writing that you would like to give the Committee as well, and then we will open to questions.

So first, Mr. Robert Pickel. Mr. Pickel is the CEO of the International Swaps and Derivatives Association. Prior to his current position, Mr. Pickel was general counsel for ISDA. Mr. Pickel has been a highly visible figure in the ongoing regulatory discussions regarding over-the-counter derivatives and has a J.D. from New York University and completed his undergraduate work at Williams College. So welcome. Good to have you with us.

Our next panelist is Larry Thompson. Mr. Thompson is managing director and general counsel for the Depository Trust and Clearing Corporation. Mr. Thompson is responsible for all legal and regulatory activities of the DTCC and its subsidiaries and he regularly interacts with government and regulatory agencies and issues impacting the company. Mr. Thompson earned his law degree at the University of California at Berkeley and obtained a B.A. degree from Yale University.

Our next panelist is Dennis Kelleher. Mr. Kelleher has over—I think we are—it looks like we are a little out of order here on how we are introducing folks. But Mr. Kelleher has over three decades of experience in the public, private, political, charitable and nonprofit sectors and has contributed four years as well of active duty to the United States Air Force and received a J.D. from Harvard Law School and undergraduate degree from Brandeis University. Welcome. Good to have you.

Our final panelist is Thomas Erickson. Mr. Erickson is here on behalf of the Commodity Markets Council. Mr. Erickson is vice president of governmental affairs at Bunge North America. Prior to his current position, Mr. Erickson was previously appointed as a commissioner of the Commodities Futures Trading Commission. Mr. Erickson received his B.A. degree in government, international affairs from Augustana College and his J.D. from the University of South Dakota, South Dakota School of Law.

So it appears as we introduced today, that we were not introducing in the order in which you are sitting, but we will go down the panel, I think, from left to right, our right, and ask each of you to speak in that order. So we welcome each of you, and Mr. Pickel, you are first.

STATEMENT OF ROBERT PICKEL, CEO, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION

Mr. PICKEL. Thank you. Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee, thank you for the opportunity to testify today. Based in the U.S., ISDA represents the full range of participants in the global OTC derivatives markets. The association squarely supports regulatory reform. We believe there has been significant progress in the past two years in building a safer, more transparent OTC derivatives market and a more robust financial system.

First, OTC derivative market participants have continued to work in advance of the onset of this new regulatory framework toward the goals of reducing counterparty credit risks and increasing regulatory transparency. We note that currently, in advance of any legally required clearing, over 50 percent of the interest rate swaps market is centrally cleared.

The volume of uncleared interest rate swaps has declined 40 percent between 2007 and 2011. ISDA and market participants have also established trade repositories for the different OTC derivative asset classes. Trade repositories collect and maintain a database of OTC derivatives transactions and these databases are available to regulators at any time, as I believe you will hear shortly from DTCC. As noted, they can play an important role in improving regulatory transparency by providing an unprecedented level of market and firm-wide risk exposures to the appropriate supervisors and regulators.

Second, U.S. policymakers over the past two years have made significant progress in defining and implementing the new regulatory framework. The scale and scope of this undertaking is considerable and within that context, it is clear that much has been achieved; even as much remains to be done.

Third, progress has also been made on an international level in understanding the need for regulatory frameworks to be consistent and coordinated across jurisdictions. This is essential to ensure a level playing field for financial markets and financial institutions and to avoid regulatory arbitrage. Global markets require global coordination.

While this progress is real, it is clear that in certain respects, the process of implementing the new regulatory framework has been problematic. It has, for example, taken longer than initially expected. Many rules and regulations have yet to be finalized. The interrelationship of Dodd-Frank-related regulations needs to be considered and assessed to avoid contradictory rulemakings. Similarly, the set of Dodd-Frank rules in the U.S. needs to be calibrated against similar frameworks in other jurisdictions.

All of these issues are causing uncertainty in the financial markets. This uncertainty imposes both direct and indirect costs that have a real economic impact, and regardless of these costs, it is highly likely that the industry, market utilities, such as clearing houses and repositories and the regulators will be unable to fully implement many provisions of the law within the requisite time frame.

It seems at this point fair to step back and ask how and where we could best facilitate regulatory implementation. ISDA and our members would suggest four concrete steps that could lead to the most progress in the shortest time frame with the fewest disruptions. First, the finalization and implementation of rulemakings should be prioritized to focus on those that are most systemically important, such as clearing and reporting.

Second, the most systemically important rulemakings should be analyzed to ensure that their implementation is properly sequenced. Third, after that sequencing is completed, U.S. regulators should continue to work with their international counterparts to ensure consistency and substance and timing of the new regulations.

The principles of restraint and regard for comity are vital in this context. Encouraging participation in U.S. markets by non-U.S. persons provides greater choice for U.S. parties, and appropriate treatment of U.S. participants in non-U.S. markets enables them to compete. Care must be taken to ensure the creation of a safe level playing field.

Fourth, the agencies need to engage in a fulsome cost benefit analysis that considers the impact of the new framework on financial institutions, corporations, market liquidity and the economy. This is not just good policy; it is the law.

ISDA and our members believe that such an approach is feasible and desirable. It would enable us to continue the important work that is being done toward our shared goal of reducing risk and increasing the stability of the OTC derivative markets. Thank you again for the opportunity to appear before the Committee, and I look forward to your questions.

[The prepared statement of Mr. Pickel can be found on page 114 in the appendix.]

Chairwoman STABENOW. Thank you very much. Mr. Erickson.

STATEMENT OF THOMAS ERICKSON, VICE PRESIDENT OF GOVERNMENT AFFAIRS, BUNGE NORTH AMERICA, ON BEHALF OF THE COMMODITY MARKETS COUNCIL

Mr. ERICKSON. Thank you. Chairwoman Stabenow, Ranking Member Roberts and members of the Committee, thank you for the invitation to appear before you today on the implementation of Dodd-Frank. My name is Tom Erickson, vice president for government and industry affairs for Bunge North America, and I am testifying today here on behalf of the Commodity Markets Council, or CMC.

CMC is a trade association that brings together commodity exchanges and their industry counterparts. The activities of CMC members include the complete spectrum of commercial end users, the futures markets, including energy and agriculture. As a group and as individuals, we support open, competitive, competitive—competitive, transparent and well-regulated markets.

While the financial crisis of 2008 had nothing to do with physical commodity markets, we recognize the need for the Dodd-Frank Act and support its goals. The CMC members have approached the implementation of Dodd-Frank from the principle of promoting market integrity while holding fast to the primary functions of the market, price discovery and risk management.

Through our comments to the various agencies, CMC has focused on those aspects of the proposed rules that in our view risk efficiency or function of the markets. In some cases, the new rules may affect liquidity, second guess hedging strategies, or present new challenges to maintaining global benchmarks in the United States. In all cases, however, the new rules will drive business decisions about how, where, whether and with whom to hedge price risks in physical commodity markets.

My comments today summarize the ongoing concerns of CMC members as Dodd-Frank implementation begins to wind down. My prepared statement provides additional detail on these, and I ask that it be entered into the record.

Congress for the first time created a statutory definition of bona fide hedge transactions in Dodd-Frank. The Commission instead has taken an approach to bona fide hedging that has given the regulatory industry at least five separate definitions of hedging. The clarity of the law is gone. It has been replaced with case by case reconsideration of the Commission.

Inter-affiliate swaps have been used effectively over the years by many firms to manage corporate risk on an enterprise basis. While the Commission has recognized the need to distinguish these activities in some rules, we understand the agency is considering imposing margin, clearing, real time reporting and other requirements to these transactions. The result would impose substantial cost on the economy, on consumers, and on end users. We urge the Commission to reconsider any such action.

With respect to recording and recordkeeping, the CFTC has proposed imposing unprecedented recordings and recordkeeping requirements across the broad swath of the cash grain marketplace to require all members of designated contract markets to capture and maintain extensive records of all communications related to cash market transactions.

Dodd-Frank was intended to address concerns about systemic risks created by an unregulated over-the-counter market. The proposed direct regulation of their cash market seems a step too far. The position limits rule requires market participants to report daily on their cash market positions as they relate to hedges held in the market.

We currently provide the Commission with snapshot data. What the Commission envisions, frankly, is impractical, where cash commodity transactions occur somewhere around the globe 24/7, oftentimes in places lacking technology. In the end, the requirement holds commercial firms to a number rather than ensuring compliance with hedging rules.

The final rule on position limits for futures and swaps required aggregation of positions between commonly-owned entities based solely on ownership and deleted a proposed exemption from aggregation for non-financial entities. CMC, along with the working group of commercial energy firms, submitted a petition to request changes to the final rule. We appreciated the CFTC's response, which advanced a proposed rule to include control over trading as a factor in determining aggregation.

Control of trading activities should be the determining factor for aggregation, not the ownership interest, because the purpose of the aggregation provision is to ensure that position limits are not circumvented by multiple entities trading in concert. If there is not common control, trading in concert should not occur.

Possibly the most important rule regulators have approved in the derivatives areas is a joint rule between the CFTC and SEC which defines who will be regulated as a swap dealer. Despite early assurances that these rules likely would require the registration of the largest 15 to 20 dealers, the final rules are estimated to require the registration of over 125 firms, including diversified businesses in the energy and agricultural sector who buy and sell commodities and who have been subject to CFTC oversight for their futures market activities for decades.

Through the implementation of Dodd-Frank, CMC has been a consistent critic of the sequencing of the rules relating to swaps. The reason is simple, commercial companies who buy and sell physical commodities never envisioned that their use of derivatives might compel registration as a dealer. Therefore, the definitions were the most important element to the rulemaking process to begin assessing the registration risk or opportunity. In fact, even with last week's final rulemaking of the swap, the physical commodity market still has no final clarity.

The Commission has asked for additional comment on trade options and volumetric optionality. Further, the end user community does not yet know to the extent to which capital and margin requirements will attach to their activities, or how to correlate swap transactions into futures equivalence. In the end, knowing the mechanics of registration are less important than knowing the definitions.

For these reasons, CMC members are struggling. Commercial agriculture and energy firms are now only able to begin to assess what activities may trigger registration and the consequent regulatory requirements and structures and systems to meet exponentially larger requirements.

In sum, we understand and respect the difficult challenge the Commission has had in implementing Dodd-Frank. That said, CMC believes the Commission's rules relating to physical commodity markets and their primary commercial users routinely fail to adequately consider the impacts to the underlying functions of the markets, price discovery and risk management. The objective should not be to discourage hedging, but rather to create markets that respect those functions. Thank you.

[The prepared statement of Mr. Erickson can be found on page 53 in the appendix.]

Chairwoman STABENOW. Thank you very much. Mr. Thompson.

STATEMENT OF LARRY THOMPSON, MANAGING DIRECTOR AND GENERAL COUNSEL, THE DEPOSITORY TRUST & CLEARING CORPORATION

Mr. THOMPSON. Thank you, Chairwoman Stabenow, Ranking Member Roberts and the members of the Committee. I am Larry Thompson, general counsel of The Depository Trust & Clearing Corporation, a participant-owned and governed cooperative that serves as a critical financial market utility for the U.S. and global financial markets.

Thank you for the opportunity to testify on Dodd-Frank, the role of swap data repositories and legal entity identifiers in a new regulatory regime. My comments will initially focus on voluntary trade reporting undertaken by market participants and then highlight the new Dodd-Frank rules which mirror the global G–20 mandates.

Consistent with the pending Dodd-Frank mandate, global regulators and the public have had access to data on both cleared and uncleared swap transactions for several years now as a result of voluntary reporting by financial institutions. The availability and the accessibility of this information has helped bring greater transparency to what was an opaque market. The next step involves regulators acquiring the analytical tools to be able to red flag excessive risk taking so action can be taken to prevent or mitigate systemic shocks to the financial system.

By way of background, comprehensive global market information on credit default swaps is published weekly by DTCC and is made available at no cost to regulators and to the public on our public website. This robust data allows parties to assess risks using timely, comprehensive information. DTCC launched a regulatory portal in January 2011 to give regulators efficient access to more granular data utilizing a set of principles that permitted global data sharing. Today, over 40 regulators use the portal, including regulators from the U.S., Europe, Asia and other regions.

DTCC is prepared to meet Dodd-Frank's swap data reporting requirements. Over the past two years, DTCC has made substantial investments to design, development and implement systems to support swap data reporting for all five derivative asset classes-credit, equity, commodities, interest rate and foreign exchange.

Two DTCC subsidiaries have applied for registration with the Commodities Futures Trading Commission to operate as swap data repositories. These new repositories are undergoing extensive user testing at this time and will be fully operational in August for interest rate and credit default swaps well in advance of the September/October reporting deadline as outlined by Chairman Gensler this morning.

As final decisions for establishing U.S. swap data repositories and global trade repositories are reached, regulators globally are concerned over the potential fragmentation of data across multiple repositories worldwide. This is best exemplified by the indemnification provision in Dodd-Frank.

It is critical during the implementation of the new reporting mandates that one, the reported data is complete and accurate, and two, a system is developed that ensures data aggregation. Regulators should allow market forces to converge to support centralization. DTCC created a repository for credit derivatives in response to market forces and with encouragement from regulators. If new systems do not ensure aggregation, data could fragment, inevitably resulting in misleading reporting of exposures.

One final thought. DTCC is committed to developing solutions to ensure regulators have complete and timely position and transaction information across all asset classes. One major concern for the Committee's consideration is that the public sector is not currently in a position to allocate scarce resources and the extensive time needed to develop data collection and reference data efforts like the Legal Entity Identifier Initiative. The financial services industry should shoulder these costs, which would free up the public sector to make investments in developing critical analytical tools and perform the required oversight.

In conclusion, significant resources have been invested in the Dodd-Frank legislative and rulemaking process. Industry participants must continue to work with regulators and Congress to ensure that the rules are adopted and implemented consistently with the statute and in a manner that supports the red flagging and mitigation of risks to the financial system. Ensuring access to comprehensive aggregated and timely data, along with regulators having the tools to analyze this information, are vital to the success of all of our efforts.

Thank you, and I welcome your questions.

[The prepared statement of Mr. Thompson can be found on page 122 in the appendix.]

Chairwoman STABENOW. Thank you very much. Mr. Kelleher, welcome.

STATEMENT OF DENNIS KELLEHER, PRESIDENT AND CEO, BETTER MARKETS

Mr. KELLEHER. Good morning, Chairman Stabenow, Ranking Member Roberts and the members of the Committee. Thank you for the invitation to Better Markets to testify today. I am the head of Better Markets, which is a non-profit, non-partisan organization that promotes the public interest in the domestic and global financial markets.

I have detailed my background and what Better Markets does in my written testimony. That is also available on our website, BetterMarkets.com, and I will not repeat that here. But I would like to say that it is a privilege to return to the Senate to testify after having been a staffer for three senators over the years. Most recently, until September of 2010, I served as chief counsel and senior leadership advisor to the former chairman of the Democratic Policy Committee, Byron Dorgan, and spent many long days and nights on the Senate floor with all of you and your colleagues. It was an honor to do so and it is an honor to be here.

Let me begin by saying, while we are here today because the financial reform law was passed two years ago, we also need to remember why that law is necessary and what happened to our country that caused us to need it. As we sit here today, tens of millions of good, hard-working Americans are suffering through the worst economy since the Great Depression of the 1930s. That is a direct result of the Wall Street-created financial collapse of 2008, which was the worst financial crisis since the stock market crash of 1929.

Tonight, many of our neighbors will sit at their dinner table. They will look their children in the eye and they are going to worry about their future. Twenty-one million Americans today cannot find full-time work. Eleven million Americans today are paying more on their mortgages than the value of their homes. Five million Americans have had to move out of their homes due to foreclosure and millions more are packing as we speak.

The American family's net worth has plummeted almost 40 percent in just three years, wiping out almost two decades of hard work and prosperity. None of this happened because of the Dodd-Frank financial reform law passed two years ago. None of this happened because of rules meant to implement the financial reform law. None of this happened because regulators are trying to make Wall Street follow the law like everybody else in our country.

That economic disaster happened as a result of Wall Street and the financial industry being deregulated in the nineties and virtually unregulated starting in 2000. That was after 70 years of unprecedented degree of government regulation of Wall Street and the U.S. capital markets as a result of the crash of '29 and the Great Depression.

Remember, during those 70 years of the heaviest regulation in history, our country prospered. We built the largest and most broad-based middle class in the history of the world, and Wall Street, our financial industry, our non-financial businesses, our farmers and our economy all thrived. Deregulation of the only industry in the country that threatens our financial system and our entire economy changed all that, and that is why the financial reform law was passed two years ago.

As is well known, derivatives in the over-the-counter markets were at the heart of causing and spreading the financial crisis. That is why title VII is vital not only to effective financial reform, but also to the protection of the American people, taxpayers, our treasury, our financial system and our entire economy.

I have detailed this and other key topics, like CFTC funding, the Volcker Rule, end users, cross-border regulation and others in my written testimony, but will mention only one key issue here. For more than 100 years, the industry has complained non-stop about regulation and cost, but history proves again and again that these complaints are without merit, that the industry has adapted and that our country and that very industry has prospered and thrived.

The latest weapon being used here in Congress in the regulatory agencies and in court, by ISDA, the Chamber of Commerce and others, is to gut the financial reform law under the guise of the innocent-sounding concept of cost benefit analysis. It seems sensible and appealing. After all, assessing and weighing the cost and benefits of taking an action appears on the surface to be reasonable. Do not be fooled.

In the context of regulation generally and financial regulation in particular, that thinking is simply wrong. One of the many flaws of this type of cost benefit analysis is that it elevates the industry's easy-to-see cost over the incalculable but often hard to quantify benefit of protecting the American people from another financial collapse and economic crisis.

For example, how do you quantify the benefit of transparency, preventing fraud or investor confidence, whether it is instilled or lost, as every member of this Committee alluded to early? In truth, today's demands for what can only be viewed as an extreme version of cost benefit analysis seek the same outcome as the industry's past demands for deregulation, different words seeking the same thing, which will lead to the same result, an extremely costly disaster for the American people, its families and its farmers.

Cost benefit analysis sounds good in theory, but it is often a catastrophe in reality and in its detail. All these issues are elaborated on in my written testimony, and I would be happy to discuss them further in questions. Thank you.

[The prepared statement of Mr. Kelleher can be found on page 87 in the appendix.]

Chairwoman STABENOW. Thank you very much. Great to have you back in the Senate on the other side of the table, so it is good to have you back.

Mr. KELLEHER. Thank you.

Chairwoman STABENOW. Let me ask first of all to each of you, once Wall Street reform is fully implemented, it obviously is critical to get it implemented in terms of reducing risk and financial markets, increasing transparency and addressing all of the things that have been said in terms of going forward for consumers and families and workers and businesses and so on.

But as the SEC and CFTC just finished the product and entity definition rules, the clock has started to run on compliance, and I would like each of you to, from your perspective, indicate if you believe the market participants are ready to comply, and if not, why not? Mr. Pickel.

Mr. PICKEL. I think it really depends on which market participants we are talking about. The larger dealers, the ones that frankly have always assumed they would be swap dealers, have taken significant steps. I mentioned the clearing that has already been done, but there are others, such as the commodity firms, who are facing the prospect of being swap dealers who would really have to start almost from scratch to put in place all those—to satisfy all those regulatory requirements.

We know that some of the larger asset management firms are facing the need to educate their customers, which is a very large base of customers, to get them to sign appropriate documentation, which is still in process, not finalized yet, even on an industry level. So there are a lot of challenges there.

I think another thing that we face is that there are—we focused on this 60 days, but actually there are a lot of different aspects of the rules that come into effect at various points in time over the next six months, and we are facing the prospect of effectively having to amend documentation at each stage along the way.

So one of the things we are engaged in with the Commission is to talk about trying to get to some common date where it would be kind of a big bang where everything comes into effect on that day and we would all plan to that date, and I think we can work together with the Commission to achieve. But that would be sometime further down the road.

Chairwoman STABENOW. Anyone else want to—Mr. Erickson.

Mr. ERICKSON. I would echo the comments of Mr. Pickel next to me. With respect to the commercial end user community, the issue, as I brought to the table, was really with the sequencing. Because for the 15 or 20 largest firms who did deal in swaps, they knew they were swaps dealers, the sequencing probably did not matter so much. But for companies who may get caught up in the swap and dealer definitions, the definitions really are the only way you can make the business decision as to whether you are going to be a swap dealer or not, or whether you are captured in those regulations, and then work back to decide how that is going to affect you.

So those costs and those decisions are really only now just starting to reveal themselves to commercial firms. With respect to other kinds of reporting, there may be also some issues with respect to some of the reporting on the position limits rules from a bona fide hedge position perspective, because commercial firms are going to be required to globally roll up all of their cash positions that they have in places that may not have the benefit of technology.

Chairwoman STABENOW. Mr. Thompson, certainly from your standpoint, technology is where you have been focused. Do you think from your perspective that folks will be ready?

Mr. THOMPSON. We believe so, Madam Chairwoman. We have been working very vigorously with the industry for the last two years to get ready to meet trace repoting mandates on a global basis. We have over 28 working groups with the industry that we are working with. We are also working with all of the regulators on a global basis—for example, the FSA, the JFSA, the MAS in Singapore—to make certain that all of the rules are going to be phased in a manner that makes sense. We spent hundreds of millions of dollars at DTCC, and we know the industry has spent more than that in preparing for the implementation of Dodd-Frank. Thank you.

Chairwoman STABENOW. Thank you. Before my time is up, Mr. Kelleher, I am going to ask you a different question. We are focused on important reforms in Dodd-Frank, but from your perspective, what else should we be paying attention to as we look to protect the economy and strengthen these markets?

Mr. KELLEHER. There are really, I would say, two issues. One has been alluded to and is a concern of every member of this Committee and frankly, the panelists, and that is the regular enforcement of the law in the commodity markets to protect investors, farmers, families, and the people downstream. All of them benefit from this.

From Peregrine to MF Global, all the way through, we do have to look hard at the self-regulatory organization model and whether or not they are resourced properly and then whether or not the CFTC and the SEC are resourced properly so that they can monitor the frontline regulators and the SROs. That is critically important or we are going to keep seeing the Peregrines of the world happen and we are going to keep seeing more victims in families and farmers that are just unacceptable.

The second issue that really needs to be focused on that has not gotten much attention, that we have tried to raise in 15 or so comment letters to CFTC, is high-frequency trading. This is, currently, the predatory conduct associated with our equity markets and is causing the confidence in those markets to drop to one of the lowest ebbs ever. That type of trading and predatory conduct is going to move into the new market infrastructure that is created in the commodity markets.

You all are going to be here, mark my words, in future years trying to figure out how to deal with those computer predators in the same way in the past we tried to deal with the Peregrines and the people predators of the past. The computer predators of the future are not getting the attention needed. Now is the perfect time to start thinking about that. As you put this market infrastructure in place you have the opportunity to address that on the front end instead of having to address it after the fact when you have victims across the land.

Chairwoman STABENOW. Thank you very much. Senator Roberts.

Senator ROBERTS. Mr. Erickson, I see from your testimony that you share my concern that the CFTC process and rule sequencing could get us into a situation where market integrity or market function is compromised. I think you stated, quote the length and complexity of many of the final rules, combined with the short compliance timelines, are making the compliance process nearly impossible.

Will your firm be able to comply by the end of CFTC's 60-day clock? That is about October 1.

Mr. ERICKSON. Senator, speaking more broadly on behalf of the membership within the CMC, that is a point of concern for a number of the companies, the commercial companies, whether they will be able to be in compliance within 60 days on those two items. One is swap dealer registration and the other is simply being able to collect all the data globally from the position limits rules.

Senator ROBERTS. Do you have any idea of the cost of compliance for your firm, other firms in the coalition you represent?

Mr. ERICKSON. Well, I think that has been one of the struggles, Senator, frankly, is developing an actual number has been very difficult, in part because of the sequencing. Because——

Senator ROBERTS. Right.

Mr. ERICKSON. —when you are looking at no definitions, you really do not know what the costs are until you can roll that up.

Senator ROBERTS. I think that is an obvious observation. What about the margin, the capital requirements for those who will be newly defined as swap dealers; will that designation cost these firms? What will that designation cost these firms?

Mr. ERICKSON. Well, for——

Senator ROBERTS. Again, we do not know. Will that designation cause your firm or other CMC members to stop trading swaps? My point is, if so, who will end up conducting this business, just the big banks? That really worries me.

Mr. ERICKSON. We see a real risk, especially in the smaller more esoteric markets, you know, the more thinly traded physical commodity markets where that is really the only hedging tool available.

Senator ROBERTS. Mr. Pickel, thank you for your four major recommendations, sequencing, getting something worked out with the international responsibilities and then the cost benefit testimony. Can you give me a good example as to why the SEC and the CFTC has two very different plans for implementing the cross-border or international component of the Dodd-Frank?

Mr. PICKEL. Well, I believe Chairman Gensler did allude to that provision in the law that he is pointing to, the one about significant and direct effect on the U.S. commerce. What I think, and certainly Congress should look at more generally, is what the implications of the application of those, whether it is the SEC or the CFTC, not just on that issue, but also on the availability of products to U.S. users of derivatives.

The fact is that while the five large U.S. institutions are significant providers, many corporations will turn to British, Swiss, German, French banks also to get quotes and to do business. Also this question of competitiveness of U.S. institutions overseas is a significant concern, I think, for the U.S. economy and for the Congress.

Then I think there is some risk, depending on where this comes out, of retaliation, quote/unquote, from other regulations, taking a similar stance which will, I think, harm U.S. companies, but also harm this market, which works around the world and requires that global coordination.

Senator ROBERTS. I appreciate that. Mr. Thompson, can you tell me more about the Depository Trust Clearing Corporation's global effort to implement, which you call the ostensible business reporting language system; are you ready to go? I think you have indicated that you are ready to go.

Mr. THOMPSON. We are ready to go, Senator.

Senator ROBERTS. What do you need from the CFTC or SEC at this point?

Mr. THOMPSON. Well, we are working collaboratively with the CFTC to secure a designation to operate swap data repositories in the U.S. The CFTC is the first out of the box on a global basis with the legal entity identifier, and it is our understanding that they have gone through a process to determine who should be the designee.

Senator ROBERTS. Well, who else is doing what you are doing?

Mr. THOMPSON. Well, we are working in a partnership with SWIFT. We do not know of any other companies right now that would have the international and global capabilities to meet the needs of regulators.

Senator ROBERTS. So in your view we do have the infrastructure?

Mr. THOMPSON. DTCC has the infrastructure in place.

Senator ROBERTS. How clued in are our regulators regarding the real world of being responsive to industry questions so they can meet the deadlines requiring them to be able to connect to the data repositories?

Mr. THOMPSON. Well, we have been, as I mentioned earlier, in user testing with participants. We have also sat down with all of the regulators to brief them on our readiness to meet the upcoming deadline, and we have spoken extensively to global regulators as well. So they are all fully aware of our readiness.

Senator ROBERTS. So quite a few folks in the U.S. Government do have access to this data?

Mr. THOMPSON. Yes.

Senator ROBERTS. Do our regulators have the technology and the analytics they need to study the data you are collecting? Are they even looking at the data that you are collecting?

Mr. THOMPSON. Well, that was one of the points that I addressed in my testimony. I think we all need to develop better analytical tools. I think the fact of the matter is we have now built the infrastructure to collect the data. The issue for the regulators is: how do you build the right analytical tools going forward to turn that data into useful information?

Senator ROBERTS. I appreciate that. Thank you.

Chairwoman STABENOW. Thank you very much. Senator Lugar.

Senator LUGAR. Thank you, Madam Chairman. Mr. Kelleher raised in his testimony the new problem of high-frequency trading. Any of the other of you have comments about how this might affect your organizations, or is this problem, as you foresee it, in the regulations? Mr. Pickel, you have——

Mr. PICKEL. We do not, in our business currently, see that. The number of trades done per day in the OTC derivative business, whether it is interest rates or credit, is a very small number as compared to the exchange-traded activity, whether it is futures or stock exchange. So we do not see that as an issue on any near term horizon within the OTC derivatives business.

Senator LUGAR. Mr. Erickson, at the small firms, is this a problem?

Mr. ERICKSON. You know, personally, I just do not know that we know enough about it yet. Certainly these are all developments that have impact on markets. It is similar to what we saw with the advent and emergence of index funds some years ago. A lot of this is new liquidity. It is different liquidity and the market needs to find a way to respond and the regulators need to find a way to adapt.

Senator LUGAR. Mr. Thompson?

Mr. THOMPSON. What I would say, Senator, is I do not think we have enough information at this point. I think Mr. Pickel, to some extent, got it correct. The swaps markets are not as heavily traded in as the equity markets where you have high-frequency trading.

However, we have the data in the swap data repositories for the regulators to analyze. This should help them better understand market structure issues going forward and to come to a conclusion as to whether or not they foresee any kind of high frequency trading. Thank you.

Senator LUGAR. I note that there is at least some tension in the testimony between Mr. Kelleher, perhaps Mr. Erickson, in the whole idea of cost benefit analysis. Mr. Erickson, at least you point out, looking at it from the standpoint of your constituents, and some are small, that this is a costly procedure.

At the same time, Mr. Kelleher's point about the cost benefit analysis being an argument against proper regulation makes a lot of sense. How do you respond to what you heard from him?

Mr. ERICKSON. Well, I would put the white hat on. I think that there are people, I am sure, who would want to use arguments in a way to try and defeat the overarching purposes of regulation. But frankly, there are a lot of people that are involved in this business day in and day out that need these markets to work well, and for those people, they are looking at these costs and benefits, and it goes to the heart of what they do. It is their ability to manage price risk.

These markets need to perform, and that is the perspective that our folks bring to that cost benefit analysis.

Senator LUGAR. I am just struck with the fact that the CFTC or the SEC or others are faced with such a myriad of different kinds of businesses and different subjects that are being regulated, that this is very difficult to draw up rules that are likely to have a cosmic effect without having particular difficulties. Yet the need to think about this is apparent.

I note, as you do, just anecdotally people suggesting that you only have about a half hours worth of work to do if you are a trader in the morning. Perhaps this is, as you say, much more with the financial markets. But you got your computer going and you can make a lot of trades fast and go off and play golf, or whatever you want to do.

This is sort of the nature of technology. At the same time that people are sitting around the table at CFTC attempting to rule make practically, and that is the value of this panel, the wide scope of small to the large and the medium in different sorts of ways, and yet the need to sort of contain this.

I have a feeling that smart guys and gals are still going to gain the system, are going to try to find out after the rules are written where the gaps are in this situation. Hopefully all of us will be bright enough either as proprietors and recognize—or as regulators, to stop the deluge before we have yet another story that somebody was brighter than the system and gouge the public.

I am just curious again from the standpoint of the small—are you confident that the fraud and abuse, at least with the small people, can be contained, or is there danger here of something out of the billion dollar significance, but something that might be very detrimental to farmers and ranchers in a particular state?

Mr. ERICKSON. Senator, you have made many great observations about the way these people respond. I think I go back to the biggest challenge, I think, from the commercial perspective and the small participants has been the sequencing of rules, because nobody knew whether they were going to be in or out. So the cost of actually looking at what systems will I need to build to support something I may never have to use, is just not something people routinely go forward.

So the regulators really do not get quality information from our industry about what the costs really will be for some of their activities. But as for fraud, the problems we are seeing in those cases it really comes down to the sad truth that there are people who will lie, cheat and steal, and that is one of the things you are trying to protect against.

Senator LUGAR. I thank you each for your testimony. Thank you, Madam Chairman.

Chairwoman STABENOW. Thank you very much. Thank you for coming today and we appreciate your input. There is still a lot of work to be done. I think overall, while we have been thoughtful moving through this process to make sure that there was input and the ability to move forward and implement effectively sequencing, timing, there is a number of issues. It is also clear that if we are going to have certainty that we need to get this done.

So I think from this perspective, certainly my perspective and the Committee, it is now time to make sure that in a thoughtful way this moves forward to be able to get done so that there is the certainty—so that the industry can do what it needs to do to be able to comply, and those that are not covered will know that.

But we certainly need to have certainty in the marketplace, I think, to be able to move forward and ultimately to protect consumers. So thank you very much.

[Whereupon, at 12:31 p.m., the hearing was adjourned.]

APPENDIX

JULY 17, 2012

Testimony on Title VII Implementation

by Robert Cook
Director, Division of Trading & Markets, U.S. Securities and Exchange Commission

Before the Committee on Agriculture, Nutrition & Forestry
United States Senate

July 17, 2012

Chairman Stabenow, Ranking Member Roberts, and members of the Committee:

I appreciate the opportunity to testify regarding the Securities and Exchange Commission's ongoing implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act").

As you know, Title VII creates an entirely new regulatory regime for over-the-counter ("OTC") derivatives. To that end, it directs the Commission and the Commodity Futures Trading Commission ("CFTC") to write a number of rules necessary to implement the statutory regime. Since the Dodd-Frank Act was enacted in July 2010, the Commission has proposed most of the rules required by Title VII. We are continuing to work diligently to implement all provisions of Title VII, and to coordinate our efforts with the CFTC and other regulators here and overseas.

My testimony today will provide an overview of these efforts to implement Title VII, emphasizing the Commission's activities since Chairman Schapiro last testified before this Committee in December.

Background

Title VII of the Dodd-Frank Act

Title VII of the Dodd-Frank Act mandates the oversight of the OTC derivatives marketplace and requires that the Commission and the CFTC write rules that address, among other things, mandatory clearing, the operation of security-based swap and swap execution facilities and data repositories, capital and margin requirements and business conduct standards for security-based swap and swap dealers and major participants, and regulatory access to — and public transparency for — information regarding security-based swap and swap transactions.

Under the Dodd-Frank Act, regulatory authority over swaps is divided between the Commission and the CFTC. The law assigns the Commission the authority to regulate "security-based swaps." The CFTC, on the other hand, has primary regulatory authority over "swaps," which represent the overwhelming majority of the overall market for over-the-counter derivatives subject to Title VII. As described more fully below, I am pleased to report that we recently adopted final rules that further define and interpret these and other key terms of the Act and that open the path to further implementation by both agencies.

With respect to the Commission's efforts, the Title VII rulemakings are designed to improve transparency and facilitate the centralized clearing of security-based swaps, helping, among other things, to reduce counterparty risk. They also are designed to enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based swaps. By promoting transparency, efficiency, and stability, this framework is intended to foster a more nimble and competitive security-based swap market and enhance regulatory oversight and monitoring of this market by facilitating improved access to comprehensive data on security-based swap transactions.

Ongoing Regulatory Coordination with the CFTC and Other Regulators

In implementing Title VII, the staff of the Commission is in regular contact with the staffs of the CFTC, Federal Reserve Board, and other financial regulators. In particular, Commission staff has consulted and coordinated extensively with CFTC staff in the development of the joint definitional rules arising under Title VII, including joint rules further defining key terms related to the products covered by Title VII, which we adopted earlier this month, and the joint rules further defining certain categories of market participants, which we adopted in April.

Commission staff also engages in extensive interagency discussions concerning rules to implement Title VII that are not required to be adopted jointly. Although the timing and sequencing of the CFTC's and Commission's proposal and adoption of these rules may vary, the objective of consistent and comparable requirements continues to guide our efforts.

The Dodd-Frank Act also specifically requires that the Commission, the CFTC, and the prudential regulators "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards" with respect to the regulation of OTC derivatives. Accordingly, the Commission is actively working on a bilateral and multilateral basis with our fellow regulators abroad to address the regulation of OTC derivatives.

Through these discussions and our participation in various international task forces and working groups, we have gathered extensive information about foreign regulatory reform efforts, identified potential gaps, overlaps, and conflicts between U.S. and foreign regulatory regimes, and encouraged foreign regulators to develop rules and standards complementary to our own under the Dodd-Frank Act. Such efforts include frequent communications and meetings with the European Union and other major foreign regulatory jurisdictions in Asia and North America. Representatives from the Commission also participate in the Financial Stability Board's Working Group on OTC Derivatives Regulation, of which a Commission representative serves as one of the co-chairs on behalf of the International Organization of Securities Commissions ("IOSCO"), and a Commission representative serves as one of the four co-chairs of the IOSCO Task Force on OTC Derivatives Regulation. In addition, representatives from the Commission, the CFTC, and a number of international regulators have met twice, most recently in May, to address cross-border issues related to the implementation of new legislation and rules to govern the OTC derivatives markets in their respective jurisdictions.

As we continue with the adoption of the Title VII rules, we remain committed to consulting with other regulators at home and abroad in an effort to foster the development of common frameworks and to help ensure a level playing field for market participants consistent with the requirements of the Act.

Title VII Implementation to Date

Adoption of Key Definitional Rules

Since Chairman Schapiro last testified before this Committee, the Commission has adopted final rules and interpretations jointly with the CFTC regarding key definitions under Title VII. Earlier this month, the Commission completed the product definitions rulemaking, and in April the Commission completed the entity definitions rulemaking. The completion of these joint rulemakings is a foundational step toward the complete implementation of Title VII. However, this step will not trigger compliance with other rules the Commission is adopting under Title VII. Instead, the compliance dates applicable to each final rule will be set forth in the adopting release for the applicable rule.

The product definitions rulemaking further defines the terms "swap," "security-based swap," and "security-based swap agreement," and adopts rules regarding the regulation of "mixed swaps" and the books and records requirements for security-based swap agreements. The product definitions rulemaking include three general categories of rules and interpretations:

- First, it sets out rules and interpretations that will assist market participants in determining whether particular agreements, contracts, and transactions are subject to Title VII.

- Second, it sets out rules and interpretations that will assist market participants in determining whether a particular Title VII instrument is a swap subject to CFTC regulation, a security-based swap subject to Commission regulation, or a mixed swap subject to regulation by both the CFTC and the Commission.

- Third, it sets out rules and interpretations that provide a regulatory framework for mixed swaps, require market participants to maintain the same books and records for security-based swap agreements as they would under the CFTC's books and records requirements for swaps, and establish a process that will allow market participants to request a determination from the Commission and CFTC of whether a product is a swap, a security-based swap, or both (i.e., a mixed swap). In addition, the rules establish a process by which persons may request modified regulatory treatment for mixed swaps by joint order of the Commission and CFTC.

The entity definitions rulemaking defines the term "security-based swap dealer" and adopts interpretations providing guidance as to how the dealer-trader distinction applies to activities involving security-based swaps. This guidance describes what constitutes dealing activity and distinguishes dealing from non-dealing activities such as hedging.

The entity rulemaking also implements the Dodd-Frank Act's statutory *de minimis* exception to the security-based swap dealer definition in a way that is tailored to reflect the different types of security-based swaps. To do so, the rulemaking exempts those entities or individuals who engage in dealing activity in security-based swaps below a certain notional dollar amount over a one-year period. The rule includes a phase-in of the exemption over time in a way designed to promote the orderly implementation of Title VII.

Additionally, the rulemaking implements the Dodd-Frank Act's "major security-based swap participant" definition through the use of three objective tests.

The Commission's Division of Risk, Strategy, and Financial Innovation was involved in the Commission's development of both of these rule sets. In particular, the Division's analysis of single-name credit default swap data was especially informative in the development of the entity definition rules. This analysis provided critically important information regarding potential dealing activity in the credit default swap market, which helped the Commission shape the final rules and evaluate their potential economic consequences. To further ensure that the entity definition rules are appropriately calibrated, the Commission has directed the staff to report to the Commission on whether changes may be warranted to the rules based on a further analysis of data after relevant provisions of Title VII are implemented. This report stems, in part, from the fact that the entity definition rules were developed based on our understanding of the existing market and currently available data. The report — together with the associated public comment — is intended to help the Commission thoroughly evaluate the practical implications and effects of the entity definition rules following the regulation of dealers and major participants pursuant to Title VII, using data reflective of the newly regulated market. More broadly, the Commission seeks to inform its rulemaking and implementation efforts through data analysis.

Issuance of Implementation Policy Statement

In June, the Commission issued a policy statement describing and requesting public comment on the order in which it expects to require compliance by market participants with the final rules to be adopted by the Commission pursuant to Title VII. The Commission's approach aims to avoid the disruption and cost that could result if compliance with all of the rules were required simultaneously or haphazardly.

The implementation policy statement is divided into five broad categories of final rules to be adopted by the Commission and explains how the compliance dates of these rules would be sequenced in relative terms by describing the dependencies that exist within and among the categories. The statement emphasizes that those subject to the new regulatory requirements arising from these rules will be given adequate, but not excessive, time to come into compliance with them.

In addition, the statement discusses the timing of the expiration of temporary relief the Commission previously granted security-based swap market participants from certain provisions of the federal securities laws. The expiration of much of this relief is tied to the effective or compliance dates of certain rules to be adopted pursuant to Title VII.

Adoption of Clearing Procedures Rules

Also in June, the Commission adopted rules that establish procedures for its review of certain actions undertaken by clearing agencies. These rules detail how clearing agencies will provide information to the Commission about the security-based swaps the clearing agencies plan to accept for clearing, which will then be used by the Commission to aid in determining whether those security-based swaps are required to be cleared. The adopted rules also include rules requiring clearing agencies that are designated as "systemically important" under Title VIII of the Dodd-Frank Act to submit advance notice of changes to their rules, procedures, or operations if the changes could materially affect the nature or level of risk at those clearing agencies.

Next Steps for Implementation of Title VII

In the near term, the Commission expects to complete the last of the core elements of our proposal phase – in particular, rules related to the financial responsibility of security-based swap dealers and major security-based swap participants. Additionally, we intend to propose rules and interpretive guidance to address the international implications of Title VII in the near term, reflecting the fact that the OTC derivatives market has grown to become a truly global market in the last three decades. The development of our cross-border approach is being informed by our discussions with the CFTC and our fellow regulators in other jurisdictions. The publication of a single proposal addressing the international implications of Title VII is intended in part to give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties. The Commission therefore anticipates that this release will be published prior to the finalization of the rules discussed therein so that the comments received can be taken into account in drafting the final rules.

The application of Title VII to cross-border transactions raises a substantial number of complex issues. Among other things, it requires consideration and appreciation of foreign regulatory frameworks and of competition concerns. This is not an easy task. However, I believe the publication of a fully developed, comprehensive Commission proposal to address these issues, and the opportunity for all interested parties to comment on this proposal, will significantly advance the level of understanding, and greatly facilitate public dialogue, on these issues.

Such a proposal will also give interested parties an opportunity to compare the Commission's approach to addressing the cross-border application of Title VII to the security-based swap market to the CFTC's recent proposed interpretive guidance regarding the cross-border application of Title VII to the swap market. In its proposal, the CFTC proposed approaches to a number of very difficult issues, such as the appropriate definition of U.S. person and the treatment of guarantees in the cross-border context. We are continuing to consider the CFTC's proposed approaches to these issues in addition to alternative approaches for the security-based swap market.

For instance, we understand the concerns the CFTC has raised regarding the ability of market participants to enter into swap transactions offshore but bring the risk of those transactions directly back into the United States. The CFTC has proposed one approach to this issue by requiring foreign swap dealers receiving U.S. guarantees to register even if they are engaged exclusively in non-U.S. business. In addition to considering this approach, Commission staff is evaluating alternative ways of addressing any risks posed to the U.S. financial system by such overseas transactions.

Similarly, the CFTC has proposed to interpret the term "U.S. person" broadly to include certain foreign entities whose swap activities or transactions have a direct and significant connection with activities in, or effect on, U.S. commerce. For example, the CFTC would include in the definition of "U.S. person" foreign entities in which U.S. persons have a majority ownership interest, as well as foreign entities in which U.S. persons are responsible for their liabilities. In addition to considering this approach, Commission staff is evaluating alternative ways to address potential risk to the U.S. financial system from business conducted outside the United States.

I expect that the Commission's proposal will address these and other issues. In particular, I expect that it will address the cross-border application of Title VII with respect to each of the major registration categories covered by Title VII relating to market intermediaries and infrastructures for security-based swaps, and transaction-related requirements under Title VII in connection with reporting, clearing, and trade execution for security-based swaps.

Additional Actions

The Commission staff continues to work diligently to develop recommendations for the Commission to adopt final rules in each of the remaining eleven areas required by Title VII where rules have been proposed:

- Rules prohibiting fraud and manipulation in connection with security-based swaps;
- Rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps that would lay out who must report security-based swaps, what information must be reported, and where and when it must be reported;
- Rules regarding the obligations of security-based swap data repositories that would require them to register with the Commission and specify the extensive confidentiality and other requirements with which they must comply;
- Rules regarding the exception to the mandatory clearing requirement for hedging by end users that would specify the steps that end users must follow, as required under the Dodd-Frank Act, to notify the Commission of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement;
- Rules regarding the confirmation of security-based swap transactions that would govern the way in which certain of these transactions are acknowledged and verified by the

parties who enter into them;

- Rules defining and regulating security-based swap execution facilities, which specify their registration requirements, and establish the duties and implement the core principles for security-based swap execution facilities specified in the Dodd-Frank Act;

- Rules regarding certain standards that clearing agencies would be required to maintain with respect to, among other things, their risk management and operations;

- Rules regarding business conduct that would establish certain minimum standards of conduct for security-based swap dealers and major security-based swap participants, including heightened requirements in connection with their dealings with "special entities," which include municipalities, pension plans, endowments and similar entities;

- Rules regarding the registration process for security-based swap dealers and major security-based swap participants; and

- Rules intended to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

Conclusion

The Dodd-Frank Act provides the Commission with important tools to better meet the challenges of today's financial marketplace and fulfill its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As the Commission and its staff continue with the implementation of Title VII, we look forward to continuing to work closely with Congress, our fellow regulators both home and abroad, and members of the public. Thank you for the opportunity to share our progress and current thinking on the implementation of Title VII. I will be happy to answer any questions.

Testimony of
Thomas J. Erickson, VP Government & Industry Affairs
Bunge North America, Inc.

On behalf of
Commodity Markets Council

Before the
Senate Committee on Agriculture, Nutrition, and Forestry
Washington, DC

July 17, 2012

Chairwoman Stabenow, Ranking Member Roberts and Members of the Committee: thank you for convening this hearing to review the implementation of the Dodd-Frank Act. My name is Tom Erickson, Vice President for Government and Industry Affairs for Bunge North America, and I am testifying today on behalf of the Commodity Markets Council ("CMC"). I am also a former Commissioner of the Commodity Future Trading Commission ("CFTC") and am pleased to be here today to share the views of CMC.

CMC is a trade association that brings together commodity exchanges and their industry counterparts. The activities of CMC members include the complete spectrum of commercial end users of all futures markets including energy and agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. CMC is well positioned to provide the consensus views of commercial end users of derivatives. Our comments represent the collective view of CMC's members.

Bunge is a member of CMC. Our role as a company in short, is as a middleman – a buffer – in a dynamic marketplace where every farmer wants the highest price possible for his or her production, every consumer wants the lowest price for food and energy, and where competition is intense to serve both the producers and consumer ends of a 7 billion member marketplace. Companies like Bunge exist to intermediate and manage production to meet demand needs. Most agricultural commodities are produced seasonally yet consumed continuously, whereas energy commodities are produced continuously and consumed seasonally. We manage that flow of physical commodity and dynamically hedge it, allowing us to offer higher prices to producers and lower prices to consumers: a key point, because interference with the hedging mechanism introduces risk that must be priced into the chain, negatively affecting both ends and everything between.

Commodity markets and their various forms of regulation have developed over 150 years. CMC and its members support well-regulated markets, and while the financial crisis of 2008 had nothing to do with commodity markets, we recognize the need for the Dodd-Frank Act and support its goals. CMC supports regulation of open and transparent markets free of fraud and manipulation. In turn, that regulation should be efficient and reasonable, not overly prescriptive and complex, as missing the right balance generates market inefficiencies and costs that affect the consumers of energy and agricultural commodities, as well as those finished food, energy and consumer products that derive from the underlying commodities. That being said, the regulatory implementation process has continued to be a source of great concern for CMC members and other commodity market participants. While we commend the CFTC for their rulemaking efforts, the sequencing of the final rules as well as the complexity of the content has stalled industry's ability to fully understand and begin the compliance process.

The CFTC has been working aggressively to implement the regulations required under the Dodd-Frank Act. On this two-year anniversary of the passage of Dodd-Frank, we are at a point in the regulatory process where it is possible to begin to assess the requirements and the benefits and challenges they present. We are not at a point of clarity, however. The law itself is multifaceted and the regulatory implementation process has exponentially increased the complexity to a daunting level. We need to move ahead with a stronger focus on ensuring that neither market integrity nor market function is compromised. Seemingly every rulemaking intended to provide clarity brings with it confusion. The length and complexity of many of the final rules combined with short compliance timelines are making the compliance process nearly impossible for many of our members. For example, the two rules defining "Swap" and "Swap Dealer" totaled nearly 1,200 pages of final rule text.

Commercial participants in the physical commodity market have always fallen squarely inside the CFTC's regulatory authority. Our members are concerned that the implementation of the Dodd Frank has become an exercise of tightening the screws on the already regulated commercial market and its participants at the expense of establishing a regime to regulate markets the CFTC has never previously regulated.

Below is a brief summary of some of the regulations, both proposed and final, that are causes of concern for CMC members.

Issues of Concern

Definition of "Hedging"
Under Dodd-Frank, Congress for the first time created a statutory definition of bona fide hedge transactions. (Section 4a(c)). Yet, it appears the Commission has chosen to use this as mere guidance. Their narrower view of the bona fide hedging rule is most acutely felt in the proposed rules to limit bona fide hedging to five specific transactions called enumerated hedges. The CFTC rules fail to adequately provide what the law clearly states.

To date, we now have at least five separate definitions of hedging – position limits, end-user exemption, swap dealer, major swap participant and Volcker rule. This creates confusion for the industry.

Inter-Affiliate Swap Transactions

Many firms use a business model through which the number of affiliates within the corporate group that enter into derivatives transactions with third-party dealer counterparties is limited. Rather than having each corporate subsidiary individually transact with dealer counterparties, a single or limited number of corporate entities face dealers. These entities then allocate transactions to those affiliates seeking to mitigate the underlying risk. This allocation is done by way of "inter-affiliate swaps" – swaps between commonly controlled entities. This structure allows the company to more effectively manage corporate risk on an enterprise basis and to secure better pricing on derivatives transactions. The transactions are largely "bookkeeping" in nature, play no role in larger market price discovery, and do not create systemic risk. The CFTC has recognized this and made accommodations in some final rules. We certainly recognize and appreciate this endeavor. We understand, however, that regulators are considering whether to subject inter-affiliate swaps to the same set of requirements that apply to swaps with external dealer counterparties – possibly including margin, clearing, real-time reporting, and other requirements. Doing so would be a mistake and would impose substantial costs on the economy, on consumers and on end-users. There has been no clarity provided by the CFTC on how these transactions will ultimately be viewed. For international companies that span multiple jurisdictions, it will become very complicated if different jurisdictions ask for intra-group transactions to be handled in different ways.

Recording and Recordkeeping Requirements

In a proposed rule described only as conforming amendments, the CFTC has proposed imposing expensive and unprecedented recording and recordkeeping requirements across a broad swath of the cash grain marketplace. The proposal would require all members of a designated contract market (DCM) such as the Chicago Board of Trade, Kansas City Board of Trade, or Minneapolis Grain Exchange to capture and maintain extensive records of all communications related to a commodity transaction. Even country elevators operated by those member firms would be required to record telephone conversations with producers when discussing cash sales or contracts, not to mention cash contract conversations by affiliates in countries around the globe where the technologies envisioned may not even exist.

The proposal presents steep technology and cost challenges to small-town country elevators who deal extensively with producers on the phone when arranging cash sales and forward cash contracts. It also raises competitive concerns because it could create a bifurcated cash marketplace by imposing the requirement on country elevators who are owned by members of DCMs but not on other companies. Who will the producer call to sell his cash grain: the elevator that has to inform him they are recording his phone calls, or the elevator a few miles down the road that is not required to do so?

The CMC believes the proposal may prompt companies who are members of a DCM to reconsider their membership in order to avoid the regulatory burden. This result exposes not only the discriminatory application of the rule, but also highlights the fundamental question within the industry about the proposed rule. Dodd-Frank was intended to address concerns about systemic risks created by an unregulated over-the-counter market. The CFTC's proposed recording and recordkeeping rule does not address any of those concerns. Rather it seems targeted at the cash market and the real commercial trade, neither of which were responsible for the financial crisis and both of which suffered because of that crisis.

Globally, this could affect the utility of the U.S. futures markets to the hedging of global production. Moreover, it could affect the competitive position of U.S. farmers. To the extent competitors and foreign exchange markets can avoid this regulation of the cash market, it will advantage them in the competition for global market share.

Reporting of Daily Positions
Requiring market participants to report daily on their cash market positions as they relate to hedges held in the market is not justified by any corresponding benefit. The physical commodity business is global, operating 24/7. Matching cash and hedge books in this environment will, in practice, lack precision. Many of our U.S. futures markets have become global benchmarks. The obligation imbedded in the rule is parochial and may undermine the U.S. futures markets' value in a global marketplace.

Position Aggregation
The Final Rule on Position Limits for Futures and Swaps required aggregation of positions between commonly owned entities based solely on ownership and deleted a proposed exemption from aggregation for non-financial entities with a lack of justification. CMC along with the Working Group of Commercial Energy Firms submitted a petition to request changes to the final rule. We appreciate the CFTC's response to the petition, which advanced a proposed rule to include control over trading as a factor in determining aggregation. The proposal, however, uses ownership as its foundation and limits the relief to ownership interests up to a level of 50 percent. While these proposed changes are constructive, it would still materially impair the operation of the commercial markets and incur significant costs. Control of trading activity should be the determining factor for aggregation, not the ownership interest because the purpose of the aggregation provision is to ensure that position limits are not circumvented by multiple entities trading in concert. If there is not common control, trading in concert should not occur.

Failure to revise the proposed rule will force commercial firms to evaluate their corporate structure for reasons unrelated to real world economics. For those who must aggregate, there will be a cost of designing, testing and implementing systems to aggregate and ensure compliance intraday, as well as additional unquantifiable costs of future potential violations, in the unintended area of antitrust.

Swap Dealers
Possibly the most important rule regulators have passed in the derivatives area is a joint rule between the CFTC and SEC which defines who will be regulated as a "Swap Dealer." Reading the Treasury proposal for financial regulatory reform and the testimony from various Administration officials leading up to the passage of Dodd-Frank, it is abundantly clear that the idea was that *"All OTC derivatives dealers and all other firms whose activities in those markets*

create large exposures to counterparties should be subject to a robust and appropriate regime of prudential supervision and regulation. " ["Financial Regulatory Reform: A New Foundation", US Dept of Treasury]. Testimony from CFTC Chairman Gensler before this Committee in 2009 reflected the belief that this dealer regulation should be targeted to a few firms:

> ...There are "**about 15 or 20 (dealers) around the globe that make up 99 percent of the market for over-the-counter derivatives.**" He referred to those that should be regulated as the "derivative dealers that are making markets. We all know their names. I will not name them here, but the large financial institutions."

According to the final rule, the CFTC estimates 125 entities will be required to register, and CMC believes that number to be much higher.

Among those being wrongly captured by the expansive definition are many commercial firms who operate diversified businesses in the energy and agricultural sector due to their role in both the buy and sell side of the physical markets. These firms transact in swaps ancillary to their physical business, but many would be caught in the final definition of Swap Dealer. As entities that have no experience being subject to regulatory capital requirements, this is certain to drive many of them from markets where they are lowering their own costs, as well as those of their customers. There will be a drying up of liquidity, particularly in smaller, more esoteric markets where the profit margins are not there for the large banks and the only entities willing to trade are those with physical market risk. By regulating these entities as Swap Dealers, the cost of hedging in the commercial space will go up. The question is how much? And at what regulatory benefit?

A Physical Commodity Market Conundrum: The Impact of Unknown Definitions

Throughout the implementation of Dodd-Frank the CMC has been a consistent critic of the sequencing of the rules relating to swaps. The reason is simple: commercial companies who buy and sell physical commodities and their products never envisioned that their use of derivatives might compel registration as a swap dealer. Therefore, definitions were the most important element of the rulemaking process to begin assessing registration risk or opportunity. In fact, even with last week's final rule defining a swap, the physical commodity market still has no final clarity. The Commission has asked for additional comment on "trade options" and "volumetric optionality." Further, the end-user community does not yet know the extent to which capital or margin requirements will attach to their activities or how to correlate swap transactions into futures equivalents. In the end, knowing the mechanics and requirements of registration are less important than knowing the underlying definitions at the outset.

For these reasons, CMC members are struggling. Commercial agriculture and energy firms are only now able to begin to assess what activities may trigger registration and the consequent regulatory requirements. Therefore, the industry will need relief from the 60-day compliance deadline.

In sum, the CMC understands and respects the difficult challenge the Commission has had in implementing Dodd-Frank. That said, CMC believes the Commission's rules relating to physical commodity markets and their primary commercial users routinely fail to adequately consider impacts to the underlying functions of the markets – price discovery and risk management. The objective should not be to discourage hedging, but rather to create a market and regulatory environment that maintains market integrity while promoting the economic benefits of risk management. We look forward to continuing our work with the Commission in this endeavor.

Thank you for this opportunity to testify. I look forward to your questions.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

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

WASHINGTON, DC

July 17, 2012

Good morning Chairwoman Stabenow, Ranking Member Roberts and members of the Committee. I thank you for inviting me to today's hearing on implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). I also will review the CFTC's settlement with Barclays on the London Interbank Offered Rate (LIBOR), as well as recent events related to Peregrine Financial Group.

I also thank my fellow Commissioners and CFTC staff for their hard work and commitment.

The 2008 crisis – caused in part by swaps – was the worst economic crisis Americans have experienced since the Great Depression. Eight million Americans lost their jobs, millions of families lost their homes and thousands of businesses shuttered.

Following the crisis, the President and the G-20 leaders convened in Pittsburgh in September 2009, and agreed that swaps, which were basically not regulated in the United States, Asia or Europe, should now be brought into the light of regulation.

In 2010, Congress and the President came together and passed the historic Dodd-Frank Act.

The goal of the law's swaps market reforms is to:

- Bring public market transparency and the benefits of competition to the swaps marketplace;
- Lower the risk of the interconnected financial system by bringing standardized swaps into centralized clearing; and
- Ensure that swap dealers and major swap participants are specifically regulated for their swaps activity.

The Commission has made significant progress in implementing Congress' direction to ensure that common-sense standards are established for the swaps market.

Turning Point: Implementation of Swaps Market Reforms

Throughout the rule-writing process, we have benefitted from significant public input. CFTC Commissioners and staff have met over 1,700 times with the public, and we have held 18 public roundtables on important issues related to Dodd-Frank reform. The agency has received more than 35,000 comment letters related to Dodd-Frank rules.

Last summer, we turned the corner and started finalizing rules. To date, we've completed 35 rules and now have fewer than 20 to go.

This month, we reached another major turning point in the swaps market reform process. The CFTC and the Securities and Exchange Commission (SEC) completed the rule to further define the terms "swap" and "security-based swap." These further product definitions mean many other critical swaps market reforms already completed by the Commission will come to life. We also finalized this month the rule on the end-user exception to clearing. With the completion of these foundational rules, we are increasingly moving from the rule-writing process to the implementation of reforms that bring transparency to the swaps marketplace and lower its risks to the public.

Swap dealers, for the first time, will register and begin to come under comprehensive regulation. This includes implementing already completed external and internal business conduct standards that will lower their risk to the economy and promote confidence in their integrity.

Two months after the rule further defining the term "swap" is published in the Federal Register, light will begin to shine on the swaps market. Initially, likely by October, swaps price and volume information will be reported in real time to the public for interest rate and credit default swap (CDS) indices. Three months later, such real-time reporting will begin for energy and other physical commodity swaps.

Swap data repositories (SDRs) will receive data on all swaps transactions, giving regulators their first full window into these markets. One SDR has already successfully registered with the Commission, and we have at least four other parties working on their applications.

The rule further defining "swap" is especially meaningful for the implementation of position limits. For the first time, limits will apply to the aggregate spot-month positions, including both futures and swaps. Spot-month limits protect the markets against corners, squeezes and the burdens that may come from excessive speculation.

I will now go into further detail on the Commission's swaps market reform efforts.

Transparency

Transparency is critical to both lowering the risk of the financial system, as well as to reducing costs to end-users. The more transparent a marketplace is to the public, the more efficient it is, the more liquid it is, and the more competitive it is.

We have completed the bulk of the congressionally mandated transparency reforms for the swaps market. This fall real-time reporting to the public and to regulators will begin for swaps market transactions.

Second, detailed and up-to-date reporting by large traders in the physical commodity swaps markets began last fall. This reporting allows regulators to better police for fraud, manipulation and other abuses.

Third, the CFTC also plans to begin publishing aggregated swaps market data. The public has benefited for years from the Commitment of Traders futures data we publish. Our goal is to provide similar public transparency for the swaps market.

Fourth, in May, we completed rules, guidance and acceptable practices for designated contract markets (DCMs). DCMs will be able to list and trade swaps, helping to bring the benefit of pre-trade transparency to the swaps marketplace.

Looking forward, we have two important transparency rules to complete related to block sizes and swap execution facilities (SEFs). These critical Dodd-Frank reforms will bring pre-trade transparency to the swaps market for the benefit of all the end-users that use swaps.

Central Clearing

For over a century, through good times and bad, central clearing in the futures market has lowered risk to the broader public. Dodd-Frank financial reform brings this effective model to the swaps market. Standard swaps between financial firms will move into central clearing, which will significantly lower the risks of the highly interconnected financial system.

The CFTC has made significant progress on central clearing for the swaps market. We have completed rules establishing new derivatives clearing organization risk management requirements.

Second, to further facilitate broad market access, we completed rules on client clearing documentation, risk management, and so-called "straight-through processing," or sending transactions immediately to the clearinghouse upon execution.

Third, we completed the rule on the end-user exception to clearing. Consistent with congressional intent, this rule ensures that end-users using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing.

Fourth, the CFTC last week also proposed a rule that would permit certain cooperatives to choose not to clear member-related swaps. Cooperatives act on behalf of and are an extension of their members. Thus, I believe it is appropriate that in certain circumstances, those cooperatives made up entirely of members that could individually qualify for the end-user exception should qualify as end-users.

In addition, the Commission has adopted four important customer protection enhancements: the amendments to rule 1.25, the gross margin rule, the LSOC rule for swaps and rules on the minimum requirements for SROs regarding their financial surveillance of FCMs.

Commissioners now are reviewing staff recommendations on clearing requirement determinations. I expect we will consider the first determinations later this month. The staff recommendations are based upon clearinghouse submissions on swaps they already clear. They begin with standard interest rate swaps in U.S. dollars, Euros, British pounds and Japanese yen, as well as a number of CDS indices, including North American and European corporate names.

Based upon the Dodd-Frank 90-day clock for making such determinations, the first clearing determinations may be completed in October just before the gross margin and LSOC rules go into effect November 8.

Commissioners also are reviewing staff recommendations on the final rule for phased implementation of compliance with the clearing requirement for various groups of financial entities.

The CFTC also has received substantial public input on the clearing of swaps among affiliates of the same financial entity. The staff recommendation, which would exempt certain affiliate swaps from the clearing requirement, is under review by commissioners.

Swap Dealers

Regulating banks and other firms that deal in swaps is central to financial reform. Prior to 2008, it was claimed that swap dealers did not need to be specifically regulated for their swaps activity, as they or their affiliates already were generally regulated as banks, investment banks, or insurance companies. The crisis revealed the inadequacy of relying on this claim. While banks were regulated for safety and soundness, including their lending activities, there was no comprehensive regulation of their swap dealing activity. Similarly, bank affiliates dealing in swaps, and subsidiaries of insurance and investment bank holding companies dealing in swaps, were not subject to specific regulation of their swap dealing activities. AIG, Lehman Brothers and other failures of 2008 demonstrate what happens with such limited oversight.

The CFTC is well on the way to implementing reforms Congress mandated in Dodd-Frank to regulate dealers and help prevent another AIG. The Commission has finished sales practice rules requiring swap dealers to interact fairly with customers, provide balanced communications and disclose conflicts of interest before entering into a swap. In addition, the Commission has finalized internal business conduct rules to require swap dealers to establish policies to manage risk, as well as put in place firewalls between a dealer's trading, and clearing and research operations. Staff will shortly provide to commissioners for consideration recommendations on a final rule on swap relationship documentation, confirmations and portfolio compression.

We completed in April a joint rule with the SEC further defining the terms "swap dealer" and "security-based swap dealer."

Based upon completed registration rules and the recently completed joint rule further defining the term "swap," we anticipate dealers will begin registering with the National Futures Association (NFA) in the early fall.

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.

Following Congress' mandate, the CFTC also is working with our fellow financial regulators to finalize the rulemaking to implement the Volcker Rule. In adopting the Volcker

Rule, Congress prohibited banking entities from engaging in proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in certain activities, such as market making and risk mitigating hedging. One of the challenges in finalizing a rule is achieving these multiple objectives.

Staff also has provided to commissioners recommendations in two other areas. The first relates to proposed exemptions for certain transactions in the electricity markets. In particular, this includes possible exemptive orders for certain transactions executed on regional transmission organizations, as well as between and among rural electric cooperatives and municipal public power providers. Second, now that the Commission made significant progress on swaps market reforms, we will consider completing a number of conforming rules.

Market Integrity/Position Limits

Financial reform also means investors, consumers, retirees and businesses in America will benefit from enhanced market integrity. Congress provided the Commission with new tools in Dodd-Frank to ensure the public has confidence in U.S. swaps markets.

Rules the CFTC completed last summer close a significant gap in the agency's enforcement authorities. The rules implement important Dodd-Frank provisions extending our enforcement authority to swaps and prohibiting the reckless use of manipulative or deceptive schemes. Thus, for example, the CFTC has clear anti-fraud and anti-manipulation authority regarding the trading of credit default swaps indices.

Also, the CFTC now can reward whistleblowers for their help in catching market misconduct.

Congress also directed the CFTC to establish aggregate position limits for both futures and swaps in energy, agricultural and other physical commodities. In October 2011, the Commission completed final rules to ensure no single speculator is able to obtain an overly concentrated aggregate position in the futures and swaps markets. With the recently completed joint rule further defining "swap," compliance for all spot-month limits will go into effect in approximately two months.

The Commission approved a proposed rule in May that would modify the CFTC's aggregation provisions for limits on speculative positions. The proposal would permit any person with a 10 to 50 percent ownership or equity interest in an entity to disaggregate the owned entity's positions, provided there are protections and firewalls in place to ensure trading decisions are made independently of one another.

Two associations representing the financial industry are challenging the agency's final rule establishing position limits in court. The Commission is vigorously defending the Congressional mandate to implement position limits in court.

Cross-border Application of Dodd-Frank's Swaps Market Reforms

The nature of modern finance is that large financial institutions set up hundreds, if not thousands, of "legal entities" around the globe. Many of these far-flung legal entities, however, are still highly connected back to their U.S. affiliates.

The lessons of the 2008 crisis and earlier have demonstrated that time and again financial transactions executed offshore by U.S. financial institutions can send risk straight back to our shores. It was true with the London and Cayman Islands affiliates of AIG, Lehman Brothers, Citigroup and Bear Stearns. A decade earlier, it was true, as well, with the collapse of the hedge fund Long-Term Capital Management.

During a default or crisis, the risk that builds up offshore inevitably comes crashing back onto U.S. shores. The recent events of JPMorgan Chase, where it executed swaps through its London branch, are a stark reminder of this reality of modern finance.

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..

The Commission, consulting closely with the SEC, the Federal Reserve and the Treasury Department, recently proposed guidance interpreting this section of the law. The Commission also proposed in a separate release phased compliance for foreign swap dealers (including overseas affiliates of U.S. swap dealers) of certain requirements of Dodd-Frank swaps market reform. Such phased compliance would enable market participants to comply with the Dodd-Frank Act in an orderly fashion and allow time for the CFTC to receive public comment on the cross-border interpretive guidance.

The proposed guidance interpreting Section 722(d) includes the following key elements:

First, it provides the guidance that when a foreign entity transacts in more than a de minimis level of U.S. facing swap dealing activity, the entity would register under the Dodd-Frank Act swap dealer registration requirements.

Second, it includes a tiered approach for foreign swap dealer requirements. Some requirements would be considered entity-level, such as for capital, chief compliance officer, risk management, swap data recordkeeping, reporting to swap data repositories and large trader reporting. Some requirements would be considered transaction-level, such as clearing, margin, real-time public reporting, trade execution, trading documentation and sales practices.

Third, entity-level requirements would apply to all registered swap dealers, but in certain circumstances, foreign swap dealers could meet these requirements by complying with comparable and comprehensive foreign regulatory requirements, or what we call "substituted compliance."

Fourth, transaction-level requirements would apply to all U.S. facing transactions. For these requirements, U.S. facing transactions would include not only transactions with persons or entities operating or incorporated in the United States, but also transactions with their overseas branches. Likewise, this would include transactions with foreign affiliates that are guaranteed by a U.S. entity, as well as the foreign affiliates operating as conduits for a U.S. entity's swap activity. Foreign swap dealers, as well as overseas branches of U.S. swap dealers, in certain circumstances, may rely on substituted compliance when transacting with foreign affiliates guaranteed by or operating as conduits of U.S. entities.

Fifth, for certain transactions between a foreign swap dealer (including an overseas affiliate of a U.S. person) and foreign counterparties not guaranteed by or operating as conduits for U.S. entities, Dodd-Frank transaction-level requirements may not apply. For example, this would be the case for a transaction between a foreign swap dealer and a foreign insurance company not guaranteed by a U.S. person.

LIBOR

I'd like now to review the CFTC's recent order against Barclays concerning the benchmarks LIBOR and Euribor.

People taking out small business loans, credit cards and mortgages, as well as big companies involved in complex transactions, all depend upon the honesty of benchmark rates like LIBOR for the cost of their borrowings. Banks must not attempt to influence LIBOR, Euribor or other indices based upon concerns about their reputation or the profitability of their trading positions.

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 of contracts in both the U.S. futures markets and swaps markets. U.S. Dollar LIBOR is the basis for the settlement of the three-month Eurodollar futures contracts traded on the Chicago Mercantile Exchange (CME), with a notional value of about $12 trillion as of the end of June. U.S. Dollar LIBOR's traded volume in 2011 on the CME was 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 included:

- 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.

The FSA is reviewing the LIBOR benchmark, and will be making suggestions as to how to improve it. Moving forward, the CFTC stands ready to assist the FSA on its review of LIBOR and how to best assure that LIBOR, or any alternative benchmark that might emerge, is not susceptible to attempted manipulation or false reporting. We look forward to working with regulators and market participants here and abroad to ensure that benchmarks for interest rates that touch borrowers and lenders and the globe are reliable and honest.

If these key benchmarks are based on observable transactions, borrowers, lenders and derivatives users around the globe all benefit. If these key benchmarks are not based on observable transactions, I believe their integrity will continue to be subject to question. And if these key benchmarks are not based on honest submissions, we all lose.

Peregrine Financial Group, Inc. and Customer Protection

Background

On July 10, the CFTC filed a complaint in federal court against Peregrine and its sole owner, Russell R. Wasendorf, Sr., alleging that they misappropriated over $200 million of customer funds from an account held at US Bank.

It was just a day earlier, on July 9, that the Commission's staff learned that its chief executive officer Mr. Wasendorf had attempted suicide and that Peregrine had only approximately $5.1 million on deposit in a customer account, while it was reporting it had over $220 million in that account.

The CFTC moved quickly to file the complaint in federal court in Chicago. In addition to the misappropriation, the CFTC's complaint alleges that the defendants failed to segregate and account for customer funds, and made false statements to the CFTC. The complaint seeks restitution for customers and civil monetary penalties. We sought an immediate order to freeze the defendants' assets and appoint a receiver. On July 10, the Court signed our requested order. Later that day, Peregrine filed for bankruptcy.

On July 13, Mr. Wasendorf appeared in court on federal criminal charges. The criminal authorities had arrested him for lying to the CFTC, and advised the court that it intended to file more criminal charges in the future.

Peregrine is a CFTC-registered FCM. The NFA, a futures industry SRO, is responsible for front-line oversight. As part of its oversight responsibility, the NFA is required to conduct periodic audits of Peregrine's customer funds in segregated and secured accounts. The NFA last completed such an audit in May 2011, and was in the process of conducting another periodic audit over the last several weeks. Furthermore, under CFTC rules, FCMs must have their annual financial statements audited by an independent CPA. As part of this certified annual report, the independent accountant also must conduct appropriate reviews and tests to identify any material inadequacies in systems and controls that could violate the Commission's segregation or secured amount requirements. Any such inadequacies are also to be reported to the SRO and the Commission. Peregrine's financials for the year ending December 31, 2011, were reviewed and certified by their independent CPA.

Peregrine used Jefferies Bache LLC, also a CFTC registered FCM, to clear its customers' futures and options trades. We understand from Jefferies that subsequent to the news of July 9, Jefferies liquidated the vast majority of Peregrine customer positions in futures and options.

The CFTC's complaint, along with the criminal charges, tells a story of deliberate dishonesty and deception. In a written statement found when he attempted suicide, as quoted in the criminal charges, Mr. Wasendorf said he committed fraud, manufactured phony bank documents, and forged bank signatures. In short, the charges against him are that he took customers' funds right out of the bank, and lied about it for years.

CFTC's Customer Protection Focus

Although we do not yet know the full facts of what happened in this matter, the system failed to protect the customers of Peregrine. Just like the local police cannot prevent all bank robberies, however, market regulators cannot prevent all financial fraud. But nonetheless, we all must do better. We must do everything within our authorities and resources to strengthen oversight programs and the protection of customer funds.

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 comingling) for swaps ensures customer money is protected individually all the way to the clearinghouse; and
- The Commission included customer protection enhancements in the final rule 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, last week, we approved an NFA proposal that stemmed from a coordinated effort by the CFTC, the SROs, and market participants, including from the CFTC's two-day roundtable earlier this year on customer protection.

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.

The CFTC also has implemented a significant restructuring, based on a new strategic plan, regarding our oversight of SROs and intermediaries.

SROs are the primary regulators of FCMs, commodity pool operators, and commodity trading advisors. Based on completed Dodd-Frank reforms the NFA also will take on additional duties with regard to swap dealers. The CFTC oversees the SROs, examining them for the performance of their duties. We review the SROs' work papers only on a limited number of FCMs each year. Historically, the CFTC only conducts a direct review of an FCM in a "for cause" situation, meaning an issue had arisen.

The CFTC last year established a new division dedicated solely to the oversight of the SROs and intermediaries. We created a branch within the division to specifically oversee examinations. We were able to attract talented individuals from the private sector with many years of relevant experience to lead this new division and branch. We have begun the process of strengthening our examination program, including adding risk and control elements. Separately, we also recently created a Consumer Outreach Office to help consumers get information about avoiding fraud.

In addition, the CFTC's enforcement arm aggressively pursues bad actors in the markets. In the last two years, the Division of Enforcement has been filing cases and opening investigations at the highest rate in the CFTC's history. Roughly half of the cases involve fraud against customers.

Since October 2009, the CFTC has brought 22 administrative cases against registered FCMs, 13 of which involved supervision failures and one of which involved a failure to maintain customer secured funds properly. In the same period, the CFTC brought two cases in federal court against FCMs, one for violating segregation rules and the other for failing to be properly capitalized and to maintain books and records.

The Commission in April charged JPMorgan Chase Bank, N.A. for unlawful handling of Lehman Brothers, Inc.'s customer segregated funds and imposed a $20 million civil monetary penalty. In another case against a public accounting firm and a CPA partner of the firm, the Commission imposed sanctions for failing to conduct proper audits of a registered FCM. In one of our supervision failure cases, a registered FCM was sanctioned for failing to follow its own compliance procedures regarding "know your customer" requirements.

Customer Protection Reforms Ahead

While the Commission's enhanced customer protection rules, staff reorganization and enforcement efforts to date have been significant, I believe we must do more. I believe we need to further enhance the agency's rules for customer protection. Staff recommendations, as outlined below, based on substantial commissioner and market participant feedback are now drafted and in front of commissioners.

First, we must incorporate the NFA rules approved last week into the Commission's regulations so that the CFTC can directly enforce these important reforms.

Second, I believe it is critical that we bring the regulators' view of customer accounts into the 21st century. We must give the SROs and the CFTC direct electronic access to FCMs' bank and custodial accounts for customer funds, without asking the FCMs' permission. Further, acknowledgement letters (letters acknowledging that accounts contain segregated customer funds) and confirmation letters must come directly to regulators from banks and custodians.

Third, I believe we need more transparency to customers about their funds. Futures customers, if they wish, should 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.

Fourth, I believe we need to consider enhanced controls at FCMs regarding how customer accounts are handled.

In addition, I believe we need to carefully consider additional rules laying out the SROs' requirements for conducting examinations and audits.

Building on the public roundtable earlier this year, I have asked CFTC staff to hold another public roundtable on these critical customer protection issues in the near future.

Regarding the Commission's oversight of SROs and intermediaries, though we're making progress through our reorganization and new rules, the recent events at Peregrine highlight the necessity of looking at the decades-old system of SROs as first-line regulators and the Commission's role in overseeing SROs.

The Commission's limited resources have historically not allowed for direct oversight of FCMs. There are 46 staff members, including 35 audit staff, on the CFTC's examinations team who oversees four SROs, which in turn have responsibilities for more than 1,000 entities. On top of the current lack of staff for examinations, our responsibilities are expanding to include reviews of many new market participants. For instance, there are currently 115 FCMs, and staff estimates a similar number of swap dealers will ultimately register. More frequent and in-depth examinations are necessary to assure the public that firms have adequate capital, as well as systems and procedures in place to protect customer money. Greater coverage by regulators – like having more cops on a beat – will improve integrity and heighten the deterrent effect of the review process.

The President's FY2013 budget, following a similar request in 2012, asked for nearly double the CFTC's current resources for the examination function to better protect the public.

Conclusion

Nearly four years after the financial crisis and two years since the passage of Dodd-Frank, the CFTC has made significant progress in implementing Congress' common-sense reforms for the swaps market.

With the foundational rules in place, it is critical that we complete the remaining reforms that will bring transparency and competition to the swaps market, lower costs for companies and their customers, and protect the public.

It is also crucial that the CFTC, working with SROs and market participants, continues its efforts to enhance protections for the funds of both futures and swaps customers.

ATTACHMENT

CFTC Dodd-Frank Update

Final Rules & Guidance

- Agricultural Commodity Definition
- Agricultural Swaps
- Anti-Manipulation
- Business Affiliate Marketing and Disposal of Consumer Information
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Derivatives Clearing Organization - General Provisions and Core Principles
- Designated Contract Markets – Core Principles
- End-User Exception
- External Business Conduct Standards
- Foreign Boards of Trade - Registration
- Internal Business Conduct Standards (Risk Management, 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 of Historical Swaps
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions – Interpretive Guidance on "Actual Delivery"
- Retail Foreign Exchange Intermediaries – Regulations & Registration
- Retail Foreign Exchange Transactions – Conforming Amendments
- Segregation for Cleared Swaps
- Swap, Security-Based Swap, Security-Based Swap Agreement -- Further Definitions (Jt. with SEC)
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories – Core Principles, Duties & Registration
- Swap Dealers and Major Swap Participants - Registration
- Swap Dealers, Major Swap Participants, and Eligible Contract Participants - Further Definitions (Jt. with SEC)
- Whistleblowers

ATTACHMENT

Proposed Rules & Guidance

- Block Rule
- Capital for Swap Dealers & Major Swap Participants
- Clearing Exemption for Cooperatives
- Conforming Rules
- Cross-Border Application
- DCMs – Core Principle 9
- Disruptive Trade Practices
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Identify Theft (Jt. with SEC)
- Implementation Phasing for Clearing
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Margin for Uncleared Swaps
- Segregation for Uncleared Swaps
- Swap Data Repository Indemnification Interpretation
- Swap Execution Facilities – Core Principles, Registration, and Process for "Made Available to Trade" Determinations
- Systemically Important Clearing Organizations – Additional Provisions
- Volcker Rule

Yet to be Proposed Rules & Guidance

- Inter-Affiliate Clearing for Financial Entities
- RTO/ISO Exemptive Relief
- 201(f) Exemptive Relief
- Stress Testing under Section 165

Final Orders

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

Studies & Reports

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

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Dennis M. Kelleher
President and CEO
Better Markets, Inc.
"The Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later"
Committee on Agriculture, Nutrition and Forestry
July 17, 2012

Good morning Chairman Stabenow, Ranking Member Roberts and members of the Committee. Thank you for the invitation to Better Markets to testify today.

Better Markets is a nonprofit, nonpartisan organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability with the goal of a stronger, safer financial system that is less prone to crisis and failure, thereby eliminating or minimizing the need for more taxpayer funded bailouts. Better Markets has filed almost 100 comment letters in the U.S. rulemaking process related to implementing the financial reform law and has had dozens of meetings with regulators. Our website, www.bettermarkets.com, includes information on these and the many other activities of Better Markets.

My name is Dennis Kelleher and I am the President and CEO of Better Markets. Prior to that, I was a senior staffer in the Senate. Prior to the Senate, I was a litigation partner at Skadden, Arps, Slate, Meagher & Flom, where I specialized in securities and financial markets in the U.S. and Europe. Prior to obtaining degrees at Brandeis University and Harvard Law School, I enlisted in the U.S. Air Force while in high school and served four years active duty as a crash-rescue firefighter. I grew up in central Massachusetts.

INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed two years ago in response to the financial collapse and economic crisis that began in 2007, reached a peak in 2008-2009, and is still being felt throughout our country today. It was the worst financial collapse since the Stock Market Crash of 1929; it almost caused a second Great Depression; it cost U.S. taxpayers and the government trillions of dollars and those costs continue to increase; and, it has produced the worst economy since the Great Depression of the 1930s.

While this is the second anniversary of the passage of the financial reform law, it is critical to remember those facts and events. It is also critical to remember that it has been almost four years since the collapse of Lehman Brothers and the peak of the financial crisis, and that the American people remain largely as unprotected today from another devastating financial crisis as they were four years ago. That context is essential to understand the financial reform law, which was passed to prevent another crisis and protect the American people, taxpayers, Treasury, financial system, and economy.

That is why the Dodd-Frank financial reform law is more properly understood as **the Wall Street re-regulation law**.

The too big to fail banks of Wall Street and the financial industry were able to cause the financial collapse and economic crisis largely because they used their economic power to gain political, academic, media and other influence that enabled them to tear down the many laws, rules, and regulations put in place during the Great Depression of the 1930s to protect the American people from Wall Street's recklessness and greed. It must be remembered that, after those laws, rules and regulations were put in place, our country did not have a financial or economic crisis on that scale for more than 70 years.

It must also be remembered that, even with all those many laws, rules and regulations – a truly unprecedented degree of government regulation of Wall Street and the U.S. capital markets – still:

- our country prospered;
- we built the largest and most broad-based middle class in the history of the world; and
- Wall Street, our financial industry, our nonfinancial businesses and our economy all thrived.

By 2000, virtually all of those protections were torn down and the too big to fail financial institutions of Wall Street were not just de-regulated, but almost entirely un-regulated. The results are clear: after 70 years of regulation that protected the American people, our financial system and our economy, it took just 7 years for Wall Street's unregulated investment, trading and other activities to cause what almost became a second Great Depression.

Those actions by Wall Street required the U.S. government to spend, lend, guarantee, pledge, assume, or otherwise use trillions of dollars to save Wall Street from itself and to prevent the crisis from becoming even worse. Every single major bank, all of the other too big to fail financial institutions, and all the systemically significant entities like money market funds, would have collapsed and been bankrupt but for the actions of the U.S. government and the taxpayer dollars used to bail them out and put them back on the road to profitability. Thus,

- JP Morgan Chase;
- Goldman Sachs;
- Morgan Stanley;
- Merrill Lynch;
- Bank of America;
- AIG;
- Citigroup; and
- all of the other financial institutions and entities that were bailed out, directly or indirectly;

are only in business today because they were all saved by the U.S. government and the American taxpayer.

But, those bailouts were only part of the costs of that crisis. The economic wreckage caused by the too big to fail banks and financial institutions and activities of Wall Street have touched every corner of our country, resulting in:

- high and persistent unemployment and under-employment;
- historically high foreclosures and underwater homeowners;
- slow-to-no economic growth;
- business failures;
- untold wealth destruction;
- widespread and growing poverty; and
- so many other costs that continue to mount, including, increasingly, a loss of belief in the American Dream.

Just one measure of these costs reveals how deep and overwhelming the crisis has been and continues to be on our country: the Federal Reserve Board recently released a study that shows that **the net worth of the median family declined 38.8% in just three years, from 2007-2010, wiping out almost two decades of hard work and prosperity – that was due entirely to the financial crisis.**

This financial and economic calamity has proved yet again that, other than war, nothing devastates a country more than the economic ruin that follows a financial crisis such as the one that began in 2007. (Better Markets tracks the cost of the crisis on its website: www.bettermarkets.com.)

The Dodd-Frank financial reform law was passed two years ago to prevent that from ever happening again. It was necessary to protect the American people, taxpayers and Treasury from the too big to fail banks on Wall Street and to eliminate or minimize the need for any future bailouts. The law is designed to do that largely by re-regulating Wall Street and systemically significant institutions and activities. After all, the financial crisis and the costs it created arose from the de-regulation and non-regulation of Wall Street. In stark contrast, the country prospered after Wall Street was comprehensively regulated for the 70 or so years after the Great Depression.

Any attempted genuine evaluation of the Dodd-Frank financial reform and Wall Street re-regulation law, or parts of it, must take these facts into account.

And, of course, any attempt to really understand the financial reform law and its impact would require considering the law as a whole and not just picking a couple of discrete parts, taken out of context, and discussing them as if they were either representative of the entire law or somehow could be properly understood as isolated standalone provisions. Thus, understanding how each provision and section relates to the entirety of financial reform and how they relate to preventing another financial collapse and economic crisis are essential to evaluating the law.

My testimony will, therefore, first review the financial collapse and economic crisis, the deregulation of the financial industry and what it has cost and continues to cost the American people. Then I will discuss the re-regulation of the financial industry and the need to shift costs from society back to the industry so that incentives and costs are properly aligned to reduce reckless behavior and the need for bailouts. Unsurprisingly, this re-regulation has caused industry to complain about its costs, but history proves that such complaints have little merit and that the industry and the country can thrive when Wall Street is properly regulated. This is true for the industry's latest attack on financial reform – an attempt to impose a burdensome cost-benefit analysis on every rule – but that tactic is also without merit, as discussed below. I will then discuss some of the derivatives reforms in Title VII. Lastly, I will address the indefensible underfunding of the CFTC. Here is an overview of the points discussed below:

- Financial reform was necessitated by the largest financial and economic collapse since the Stock Market Crash of 1929 and the Great Depression of the 1930s, and it was enacted to prevent a second Great Depression.

- The benefits of avoiding another financial crisis are enormous, totaling trillions of dollars, measured not just in terms of the current crisis but also in light of a potentially worse financial disaster that may befall our country if reform is not fully implemented.

- Effective financial reform that protects the American people requires the re-regulation of the financial industry and that will result in shifting costs back to the industry from society where it was shifted when the industry was de-regulated.

- Industry always complains about the alleged costs and disruption of regulation, but history proves that they are without merit

- The latest attack on financial reform and re-regulating Wall Street is the claim that no rule passed to implement the law protecting the American people can cost industry too much, which ignores how much Wall Street has cost America.

- Derivatives played a key role in the precipitating and transmitting the financial crisis and collapse; derivatives regulation is an essential part of the comprehensive financial reform and to protecting the American taxpayer from again having to bail out the financial industry.

- The Volcker Rule.

- Cross-Border application of derivatives protections.

- International harmonization.

- The CFTC is the only police force on the derivatives beat and it needs substantially more funding to protect the American people properly.

Financial reform was necessitated by the largest financial and economic collapse since the Stock Market Crash of 1929 and the Great Depression of the 1930s, and it was enacted to prevent a second Great Depression

As the aftershocks of the Lehman Brothers bankruptcy shook the world in September of 2008, the U.S. and global financial system seized up and nearly collapsed. Only massive, multi-trillion dollar interventions by the U.S. government and international institutions prevented that calamity in the fall of 2008 and the spring of 2009. Making matters worse, as the **financial system** was unraveling, the U.S. and global **economies** were also grinding to a halt. That too required multi-trillion dollar governmental actions to prevent a second Great Depression.

The wave of bailouts, buyouts, and other rescue efforts that were undertaken to support the nation's leading financial institutions revealed the depth of the unfolding crisis. In the days and weeks after the Lehman bankruptcy, the U.S. government nationalized Fannie Mae and Freddie Mac, and then effectively nationalized AIG and Citigroup through bailouts totaling hundreds of billions of dollars. To prevent their inevitable bankruptcies, investment banks Goldman Sachs and Morgan Stanley were allowed to quickly convert into bank holding companies, thereby receiving full access to the federal safety net. Bank of America acquired investment bank Merrill Lynch, and Wells Fargo acquired Wachovia (derailing Citigroup's attempt to buy Wachovia only days before). The nation's largest savings and loan association, Washington Mutual, failed, was seized by regulators, and was ultimately sold to JP Morgan Chase at a bargain basement price (similar to the bargain price JP Morgan paid for Bear Stearns in March 2008).

Throughout this time, the U.S. government was creating innumerable rescue programs to prevent any financial institution or sector of the financial industry (including the $3.8 trillion money market fund industry) from collapsing. The much ballyhooed $700 billion TARP program was but one of the countless emergency measures adopted during this time.[1] And, it must be remembered that the U.S. government also assisted foreign banks and financial institutions throughout the world, not just those in the U.S. The pace and scale of

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[1] In what appears to be yet another attempt to minimize and understate the depth and cost of the crisis, some talk misleadingly as if TARP was the only government rescue program and some even claim that TARP will make money. That is not accurate. TARP is currently projected to cost at least $60 billion. However, even if all the money TARP lent was paid back, that doesn't mean it would have "made" money. The meritless claim that has been made by people who know better is that if TARP (or any one of the other bailout programs) takes in one penny more than it lent (or the other programs spent, pledged, guaranteed, or otherwise used), then it made money. That is simply misleading propaganda. The only proper way to evaluate any of these programs is what any return was or should have been on a **risk adjusted basis**. By that measure, not only have none of the government bailouts "made" money; they have all cost taxpayers and the government hundreds of billions if not trillions of dollars (above and beyond all the other costs).

deteriorating events was unprecedented, as the contagion from the liquidity and solvency crises spread rapidly to every corner of the financial system and the globe.

But even those unprecedented actions, programs, and interventions – representing trillions of dollars – were not sufficient to stop the multiple crises from spiraling out of control, as almost every financial indicator continued to deteriorate and to do so at an accelerating pace into 2009. Indeed, as late as February 2009, **more than five months after the Lehman bankruptcy,** the financial systems and economies of the U.S. and the global community were still declining rapidly, with no bottom in sight. Policymakers were facing a very dark and dangerous abyss and **the possibility of a second Great Depression was a very real and increasingly likely prospect**.

In response, the U.S. government took additional unprecedented actions. For example, on February 23, 2009, it announced that the full faith and credit of the United States would stand behind **the entire financial system, which was thus effectively nationalized,** as set forth in this dramatic policy statement:

> A strong, resilient financial system is necessary to facilitate a broad and sustainable economic recovery. The U.S. government stands firmly behind the banking system during this period of financial strain to ensure it will be able to perform its key function of providing credit to households and businesses. The government will ensure that banks have the capital and liquidity they need to provide the credit necessary to restore economic growth. Moreover, we reiterate our determination to preserve the viability of systemically important financial institutions so that they are able to meet their commitments.

Joint Statement by the Treasury, FDIC, OCC, OTS, and the Federal Reserve (Feb. 23, 2009) (full statement available at http://www.federalreserve.gov/newsevents/press/bcreg/20090223a.htm).

That historic step was followed by others, and trillions of additional government dollars were spent, lent, pledged, guaranteed, or otherwise used in an all-out effort to prevent a second Great Depression. We now know that those actions somehow worked, that the financial system did not entirely collapse, and that a second Great Depression was avoided. Having lost 54 percent of its value since its October 9, 2007 high, we also now know – with the benefit of hindsight – that the stock market hit its lowest point on March 9, 2009 and that the precipitous and uncontrolled decline of the financial markets and the economy stopped sometime in the March-April 2009 period.

However, and most important, **even to this day no one knows** exactly why or how complete disaster was averted. No one knows which policy, program, intervention, action, or expenditure – or what combination or order of those measures – arrested the downward spiral.

Nevertheless, the need to prevent such a calamity from ever happening again is overwhelmingly and indisputably clear: Not only did the financial collapse and economic crisis cost many trillions of dollars, it also caused vast, unquantifiable, and still-ongoing human suffering, from skyrocketing unemployment, millions of home foreclosures, widespread poverty, and enormous wealth destruction, to foregone retirements, obliterated college funds, and, for many, the lost American Dream. This proved yet again that, other than war, nothing devastates a country more than the economic ruin that follows a financial crisis such as the one that began in 2008.

That is why comprehensive financial reform and the re-regulation of Wall Street was essential. The Dodd-Frank law is intended to protect the American people, taxpayers, and the U.S. Treasury from ever again having to suffer through and pay for another financial collapse and economic crisis. Above all, it is intended to prevent a second Great Depression from afflicting the United States. That dire outcome was avoided, but just barely and through a measure of good luck. The American people may not be so fortunate next time and, most importantly, they should not have to depend on luck. They should have the benefit of laws, reforms, rules, and regulations to protect them, and they should be able to count on their elected representatives and regulators to fulfill their duties and ensure that those safeguards are put in place.

That is what Dodd-Frank financial reform law is all about and how it should be evaluated.

The benefits of avoiding another financial crisis are enormous, totaling trillions of dollars, measured not just in terms of the current crisis but also in light of a potentially worse financial disaster that may befall our country if reform is not fully implemented

It cannot be legitimately denied that the value of a stronger and more comprehensive regulatory system is huge. It includes the benefits of sparing our economy and our society the devastating consequences that another financial collapse and economic crisis would bring in the form of both monetary losses and human suffering.

A reasonable starting point for determining the cost of a future crisis is the cost of the recent financial collapse and ongoing economic crisis. The impact of that crisis is staggering. Better Markets has a detailed analysis of the costs of the crisis on its website (www.bettermarkets.com), but here are some snapshots of the financial devastation it caused:

- Gross domestic product ("GDP") has fallen dramatically and it is not expected to return to normal levels until at least 2018. At that time, the cumulative shortfall in GDP relative to potential GDP is expected to reach **$5.7 trillion**.

- The unemployment rate skyrocketed to 10.1 percent in October of 2009, representing **15.4 million workers**, many of whom have become members of the permanently unemployed.

- Government expenditures, including corporate bailouts, special lending facilities, unemployment benefits, and the economic stimulus package are well in excess of a trillion dollars. The value of the government's total commitment of support, provided through some 50 separate programs, is estimated at **$23.7 trillion**.

- The national debt will increase by **$8 trillion** as of 2018 as a result of the crisis, due to the combined effects of government expenditures and reduced revenues.

- The stock market fell by more than 50 percent in just 18 months, from October 2007 until March of 2009, representing **$11 trillion** in evaporated wealth.

- From 2007 to 2010 median family income **fell 7.7 percent**, from $49,600 to $45,800.

- Over those same three years, median family net worth **fell 38.8 percent**, which totals **more than $7 trillion, "erasing almost two decades of accumulated prosperity.**" (From peak in July 2007 to trough in January 2009, households lost **$19 trillion** in wealth, according to the Fed (adjusted to 2011 dollars)).

- Home values have declined 33 percent since the crisis began, representing **$7 trillion** in lost value.

- Over **11 million** homeowners own homes worth less than their mortgages, or about 22.8 percent of all residential properties with a mortgage.

- A total of **at least 3.6 million** homes—and by some accounts **5 million**—have been lost to foreclosure since the crisis began, with millions of additional foreclosures to come.

- The number of families falling below the poverty line has climbed steadily since 2007, rising from 12.5 to 15.1 percent, representing over **46 million** individuals deemed poor.

- The **human anguish** caused by the crisis has been enormous and incalculable, encompassing all of the psychological and physical health effects that come with unemployment, poverty, homelessness, delayed retirements, abandoned college educations, increased crime rates, and lost healthcare.

- Maybe worst of all, the faith of the American people in **The American Dream**, where the U.S. is the land of opportunity, everyone gets a fair shot, and the next generation will have it better than the last, is dropping at an alarming rate, which could undermine the spirit of our country.

It is impossible at this point to quantify all of the consequences of the still-unfolding economic crisis. Moreover, the actual costs of another crisis are almost certain to be far greater than what we have witnessed since 2007. This is attributable to the fact that our fiscal and monetary capacities to institute remedial measures and to absorb the costs of a future crisis have now become so depleted. With the annual budget deficit now exceeding 1.2 trillion dollars, the Treasury will have far fewer fiscal tools at its disposal with which to manage another financial crisis. This vulnerability will persist for years to come, until something approximating a full recovery has been achieved, and no one is expecting that for a very long time.

From 2007 to 2010, the U.S. government responded to the financial and economic crisis by implementing trillions of dollars in emergency measures to prevent a precipitous slide into a second Great Depression. To create a more lasting safeguard against another financial crisis, the comprehensive reforms in the Dodd-Frank law were passed. Those reforms promise an enormous **collective benefit** -- avoiding the costs of what would likely be a second Great Depression -- but only if they are implemented on a **collective basis**.

Therefore, as legislators evaluate the law, as regulators promulgate rules under the law, and as courts review those rules, they must consider the entire set of reforms enacted and the benefits that those reforms can provide as a single, coherent collection. If the cohesive framework envisioned in the financial reform and Wall Street re-regulation law is not understood and evaluated this way, then the public, the markets, and the economy as a whole will once again be vulnerable to another financial catastrophe.

Effective financial reform that protects the American people requires the re-regulation of the financial industry and that will result in shifting costs back to the industry from society where it was shifted when the industry was de-regulated

Over a three-year period beginning in 2007 and culminating in the passage of the financial reform and Wall Street re-regulation law on July 21, 2010, the U.S. government witnessed the financial and economic destruction caused by the crisis, implemented emergency measures to contain it, and then made the judgment that comprehensive reforms were essential to protect investors, taxpayers, the Treasury, the financial system, and the economy from another financial crisis. That will necessarily result in the industry assuming their proper regulatory costs and burdens, which is necessary to prevent those costs from being shifted to taxpayers and society. Those burdens include initial and ongoing compliance costs as well as the elimination of extremely profitable lines of business.

Those consequences were well known, but nevertheless intentionally imposed to **re-regulate the recently de-regulated financial industry**, thus closing regulatory gaps and strengthening existing requirements for the benefit of investors, the public, and the entire economy.

The financial industry was very significantly regulated after the Stock Market Crash of 1929 and during the Great Depression. Those regulations protected the public, investors, taxpayers, the financial system, and the economy for seven decades. It was no accident that they prevented a repeat of the Crash of 1929 and the Great Depression for more than 70 years. However, those regulatory protections were removed, primarily during the 1990s, reaching a peak in 1999 with the passage of the Gramm-Leach-Bliley Act of 1999 and in 2000 with the passage of the Commodities Futures Modernization Act.

Thus after seventy years of heavy regulation, it took just seven years after de-regulation for the financial industry to engage in the high risk trading and reckless investments that nearly collapsed the financial system and almost ushered in a second Great Depression. While the costs are still being counted and incurred, the U.S. government had to spend, lend, pledge, guarantee, insure, or otherwise use trillions of dollars to prevent the full collapse of the financial system and halt the economic crisis.

The primary motivations in passing the Dodd-Frank financial reform and Wall Street re-regulation law were to prevent such a financial collapse and economic crisis from ever happening again, and to avoid a second Great Depression. In many respects, the reforms in the Dodd-Frank law re-regulate the financial industry as it had been regulated beginning in the 1930s. **This re-imposition of regulation also means shifting the substantial costs of risky behavior and predatory practices from the public back onto the industry**—or, as economists would say, forcing the industry to assume the costs of the externalities that they imposed on society when they were deregulated.

Title VII illustrates this legislative resolve. It establishes a broad range of regulatory requirements in the previously unregulated swaps markets. For example, Title VII requires, among other things:

- Registration of market participants to ensure their fitness;
- Recordkeeping and reporting to enable regulators to oversee market activities;
- Exchange trading, central clearing, and public disclosure of transaction information to protect investors, reduce risk, increase transparency, price competition, and a level playing field;
- Business conduct standards and prohibitions against conflicts of interest to prevent fraud, abuse, and unfair economic advantage;
- Position limits, capital, collateral, and margin requirements to mitigate risk;
- Chief compliance officers to foster compliance from within the industry and to complement regulatory oversight; and
- Enforcement provisions to induce compliance with all of the requirements.

There is no genuine dispute that these measures are necessary to bring integrity and stability to the derivatives markets. And it is equally clear that these reforms would be impossible to implement without imposing significant compliance costs on market participants, who will be required to pay filing fees, hire new staff, upgrade and maintain information technologies, and alter their business procedures. These reforms are also impossible without eliminating or scaling back profits derived from abusive or highly risky conduct.

Thus, the Dodd-Frank financial reform law and the regulations promulgated thereunder must necessarily (1) prohibit some activities, including fraudulent transactions and those based upon conflicts of interest; (2) curtail other behaviors, including excessive speculation; (3) force the reallocation of funds to other uses, such as capital and margin; and (4) increase transparency and competition through pre- and post-trade reporting, thus reducing profit margins.

Further illustrating this approach, the Dodd-Frank law imposes a broad set of regulatory reforms on bank holding companies and nonbank financial institutions, with the focus on systemically important institutions. They will pay necessary compliance costs from new requirements relating to registration, reporting, recordkeeping, public disclosures, risk committees, examinations, fees, and capital and leverage requirements, among other enhanced supervisory prudential standards. Key provisions of the statute will also eliminate some immensely profitable trading activities. Most notable is the "Volcker Rule," which prohibits insured depository institutions, bank holding companies, and certain nonbank companies from almost all proprietary trading and all but *de minimis* investment in hedge funds. These bans on highly profitable activities will effectively eliminate billions of dollars in annual revenue for the largest banks. But, they are necessary to protect the American people, taxpayers and Treasury from Wall Street.

The Dodd-Frank financial reform law imposes new requirements in many other sectors of the financial industry as well. Title IV establishes registration and reporting obligations for private fund advisers; Title IX enhances the regulation of securities firms, rating agencies, and securitizers; Title X creates an entirely new regulatory body for consumer financial products and services; and Title XIV extensively reforms mortgage lending and increases regulation of mortgage loan originators.

Given that the ongoing costs of the last financial collapse and economic crisis have exceeded trillions of dollars, the enormous collective benefits of the financial reform and Wall Street re-regulation law far exceed the costs and lost profits that industry will have to absorb as the price for protecting the American people, taxpayers, Treasury, and economy.

Industry always complains about the alleged costs and disruption of regulation, but history proves that they are without merit

Critics argue that the costs of the Dodd-Frank financial reform and Wall Street re-regulation law are or will be excessive and that they will cripple the financial industry and even stifle economic recovery from the financial crisis. However, using the past 100 years as a guide, there is no basis for the claim that the essential reforms, even on the scale required by the Dodd-Frank financial reform law, will produce these consequences.

Since the emergence of financial market regulation, the financial services industry has argued that new regulatory requirements will have a devastating impact by imposing unbearable compliance costs. Yet Wall Street has always absorbed the cost of those new regulations and has consistently remained one of the most profitable sectors in our economy. For example, a century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary" attack upon legitimate business that would cause nothing but harm. However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely.

Subsequently, when the federal securities laws were adopted in the midst of the Great Depression, Wall Street staunchly opposed them, claiming that they would slow economic recovery by impeding the capital formation process and discouraging the issuance of new securities – virtually identical arguments that industry is making today. However, in the years after the enactment of the federal securities laws, the nation's securities markets flourished and became what has often been described as the envy of the world. The same pattern has been repeated with each new effort to strengthen financial regulation, including deposit insurance, the Glass-Steagall Act, mutual fund reform, and the national market initiatives of the mid-1970s.

The lesson to be learned from this history is that when faced with new regulations, members of the regulated industry routinely argue that the costs and burdens are too heavy—but then they invariably adapt and thrive. Opponents of reform under the Dodd-Frank law are following this familiar pattern, and their attempts to minimize regulation by invoking the costs and burdens must be similarly discounted.

Equally unfounded is the claim heard from opponents of regulatory reform that regulation is stifling overall economic growth and preventing a robust recovery from the financial crisis. This claim is unsupported, often just repeated as a self-evident proposition. In fact, the slow pace of economic recovery is not attributable to regulation but instead to rampant unemployment and lack of consumer demand following the worst financial crisis since the Great Depression. We need more financial regulation, not less, to ensure that the economy recovers and that we never again experience such a profound and long lasting financial disaster.

"Economists who have studied the matter say that there is little evidence that regulations cause massive job loss in the economy, and that rolling them back would not lead to a boom in job creation." In fact, the Bureau of Labor Statistics continuously surveys the private sector to understand the reasons for layoffs. Data for 2010 shows that only 0.2 percent of the people who lost their jobs in layoffs were let go because of government regulation. By comparison, 30 percent were let go because of a drop in business demand.

In survey after survey, business owners consistently say that their reluctance to hire employees and expand production arises from uncertainty about consumer demand for products and services, not concern over regulation. One policy analyst recently canvassed numerous sources on the impact of financial regulation, ranging from the Bureau of Labor Statistics, the Wall Street Journal, the McClatchy Newspapers, and business trade data. The surveys and data collected from these organizations debunk the myth that either existing regulation or uncertainty about future regulation over financial services is responsible for the current economic stagnation. For example, a Wall Street Journal survey of business economists found that "[t]he main reason U.S. companies are reluctant to step up hiring is scant demand, rather than uncertainty over government policies."

Even as additional and essential regulations are being adopted, corporate America is actually faring well. Regulation is clearly not interfering with corporate profits, cash reserves, or executive compensation. Corporate profits are at record levels, representing over 10 percent of GDP after tax, and executive compensation has nearly regained its pre-recession levels, with a reported remarkable 27 percent increase in median pay in 2010. That level of compensation remained steady and even increased somewhat in 2011, with the top 100 CEOs receiving a total of $2.1 billion in compensation.

The stagnant consumer demand holding back economic growth was a direct result of the financial collapse and economic crisis, which were a direct result of **too little** regulation. In the years leading up to the crisis, huge sectors of our financial markets (such as swaps) were completely unregulated, and other sectors (such as mortgage-backed securities) were poorly regulated.

The resulting costs of the crisis are enormous and lasting. As set forth in summary fashion above and in detail on our website (www.bettermarkets.com), they include unemployment of tens of millions of Americans, a massive drop in GDP, a huge decline in home values, and decimated retirement accounts. These costs, inflicted by the financial collapse caused by Wall Street, are what brought our economy to a standstill, not excessive regulation. Regulated, transparent markets with less fraud and reckless conduct will restore confidence in our markets and banks. That will in turn help economic growth and confidence.

Moreover, industry's claims that financial reform will reduce market liquidity, capital formation, and credit availability, and thereby hamper economic growth and job creation, simply disregard the fact that the financial crisis did more damage to those concerns than any rule or reform possibly could. In September 2008, there was no market liquidity, capital formation or credit availability and, since then, there has been little economic growth and even less job creation. That is due to the Wall Street created financial collapse and economic crisis. The financial reform and Wall Street re-regulation law was passed and is designed to prevent that from ever happening again.

The latest attack on financial reform and re-regulating Wall Street is the claim that no rule passed to implement the law protecting the American people can cost industry too much, which ignores how much Wall Street has cost America

Having failed to prevent the passage of a comprehensive financial reform law, the financial industry is redoubling its efforts to make sure the law is never implemented as intended. What that means is that they are trying to prevent the protection of the American people, taxpayer, Treasury, and economy from suffering **again** as a result of their unregulated conduct and activities.

Their latest weapon to kill or weaken financial reform is to claim that every rule and regulation passed to implement the Dodd-Frank financial reform and Wall Street re-regulation law must be subjected to exhaustive "cost-benefit analysis," which is a seductively innocent sounding phrase. Indeed, it is an activity that on its face seems sensible and appealing. After all, assessing and weighing the costs and benefits of taking an action appears on the surface to be reasonable. However, in the context of regulation generally and financial regulation in particular, that thinking is simply wrong and it will likely kill financial reform, as the too big to fail banks on Wall Street and their allies have intended all along.

Moreover, it is a ridiculous argument: the very industry that caused the financial collapse, economic crisis, and trillions of dollars in costs – many that continue to this day – now claims that it cannot be re-regulated to prevent it from causing yet another crisis **if** the costs it must bear are too great. That is irrational. The American people, taxpayer, Treasury, and economy have to be protected from Wall Street; Wall Street doesn't have to be protected from regulation. In fact, Wall Street must be re-regulated because when it is deregulated and unregulated it causes financial collapse, economic crisis, and trillions of dollars in costs – all of which the American taxpayers have to pay.

Nonetheless, the industry is making this argument in the regulatory process and in lawsuits filed to prevent Wall Street from being re-regulated. For example, the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA) have sued the CFTC over what is referred to as its "position limits" rule claiming, among other things, that the CFTC did not conduct the proper cost-benefit analysis. Better Markets filed a brief opposing that argument and detailing why it is without merit. More recently, the Chamber of Commerce and the Investment Company Institute (ICI) have sued the CFTC over re-establishing a registration requirement for investment companies acting as commodity pool operators. Better Markets also filed a brief in this case detailing why industry's claims are without merit.[2]

In addition, Better Markets has just completed a report that it will be issuing shortly entitled "Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC." Many of the arguments applicable to the SEC are also applicable to the CFTC. The Report comprehensively reviews these cost-benefit claims and demonstrates that these arguments are without merit and must be rejected. I will just mention but a few of the reasons why this latest attack on financial reform must be rejected.

First, cost-benefit analysis generally assumes that all or most of the material costs and benefits of a regulation are quantifiable and comparable. In reality, **costs** are much easier to identify and calculate than **benefits**, which are often as much qualitative as quantitative. For example, if the SEC adopts a rule that prevents fraud and manipulation in the securities markets, how can the enormous benefit to investors and to society of an honest, un-manipulated market be calculated? Indeed, financial markets can serve their fundamental purpose as a capital-raising mechanism **only** if investors have confidence in those markets, believing them to be fair and free of fraud and manipulation (at least to some tolerable level). How can the benefit of that confidence and that willingness to participate be quantified? In

[2] *See* Brief of Better Markets, Inc. as Amicus Curiae in Support of Defendant Commodity Futures Trading Commission, Inv. Co. Institute v. CFTC, No. 1:12-cv-00612 (BAH) (D.D.C. 2012) (filed June 29, 2012), *available at* http://bettermarkets.com/sites/default/files/ICI%20v.%20CFTC%20-%20Amicus%20Brief%20of%20Better%20Markets%20June%2025,%202012.pdf; Corrected Brief of Better Markets, Inc. as *Amicus Curiae* in Support of Defendant Commodity Futures Trading Commission, Int'l Swaps and Derivatives Ass'n v. CFTC, No. 11-cv-2146 (RLW) (D.D.C. 2011) (filed May 1, 2012), *available at* http://bettermarkets.com/sites/default/files/Amicus%20Brief%20CFTC%204-30-12.pdf.

sharp contrast, companies that must hire new staff and buy information technology to fulfill their compliance obligations know exactly how to quantify those costs. Thus, a cost-benefit analysis almost always favors industry and overweighs its costs. Conversely, no matter how much society, investors, and others benefit, those benefits are often amorphous and difficult to quantify.[3]

This problem is especially pronounced in connection with the rulemaking arising from the Dodd-Frank Act. Currently, the process is centered on each individual rule being proposed and then finalized by each agency. However, the Dodd-Frank Act was not passed by the Legislative and Executive Branches with this narrow focus in mind. The law was passed as a comprehensive and integrated whole designed and intended to prevent another financial collapse and economic crisis. In fact, it was passed to prevent a second Great Depression. Avoiding that calamity—if indeed it can be avoided in the future—will be the historic accomplishment of the Dodd-Frank Act, but how is that enormous benefit quantified? Such questions illustrate the fundamental flaw in applying cost-benefit analysis to the process of regulatory reform (and they also explain why the Legislative and Executive Branches decided not to impose such a condition on the implementation of financial reform).

Second, with regulation, even if the costs are higher than the benefits by some measure, a society often decides that the benefits in the long run still outweigh the costs. For example, if predatory and subprime lending had been stopped in the early 2000s (as a number of State Attorneys General tried to do before being thwarted by federal banking regulators[4]), many if not all of the ingredients of the crisis might not have materialized. How would that benefit be quantified? And, if the 3.6 million home foreclosures since 2008 could have been avoided, how would a regulation that provided such a benefit be measured? It would have to include not only the economic costs averted—including a massive decline in household wealth, losses sustained by lenders, hollowed-out communities, and others—but also the incalculable human suffering that could have been avoided as well.

This imbalance in cost-benefit analysis is starkly illustrated in the auto safety context. Ford's decision regarding exploding gas tanks in Pintos may be the best example: Ford calculated that it would cost $137 million to correct a fatal design defect, but just $50 million to pay the claims of the estimated 180 people killed and 180 people injured from that defect.[5] From one point of view, this cost-benefit analysis may make perfect economic sense: Spend

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[3] Financial regulation provides many examples of the distorted nature of cost-benefit analysis, and preventing market manipulation is only one of them. For example, the same point applies to measuring the benefit to society of bringing transparency and regulation to the shadow banking system, including in particular the $700 trillion derivatives market. The benefit of that transparency is enormous, but also impossible to quantify with any degree of accuracy. Pricing that benefit is even more challenging under the currently fragmented rulemaking process, where the impact of each rule is viewed in isolation rather than as part of a coherent collection of reforms. *See, e.g.,* ZOLTAN POZSAR ET AL., SHADOW BANKING, FED. RESERVE BANK OF NEW YORK, STAFF REPORT NO. 458, (July 2010, revised Feb. 2012), *available at* http://www.newyorkfed.org/research/staff_reports/sr458.pdf.

[4] Eliot Spitzer, *Predatory Lenders' Partner in Crime,* Washington Post, Feb. 14 2008, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/02/13/AR2008021302783.html.

[5] *See* DOUGLAS BIRSCH & JOHN H. FIELDER, THE FORD PINTO CASE: A STUDY IN APPLIED ETHICS, BUSINESS, AND TECHNOLOGY 51-52 (State Univ. of N.Y. Press, 1994).

$137 million to save 180 lives and prevent another 180 injuries, or spend $87 million **less** by just paying for the deaths and injuries. However, it also serves as a perfect illustration of the deficiencies of cost-benefit analysis from the perspective of society rather than an individual corporation or industry: It ignores unquantifiable human consequences as well as the moral component in regulatory decision-making.

Third, it is often assumed that the people advocating for cost-benefit analysis are doing so in good faith, with an open mind, and for the purpose of genuinely determining the most appropriate outcome, considering all relevant factors in context. That, however, is often not true, and it is decidedly not what is happening in the debate over financial reform. Almost all of the **proponents** for what they call "cost-benefit analysis" in financial regulation are **opponents** of financial reform (either expressly or in fact). The two perspectives go hand-in-hand. For example, Senator Richard Shelby, who voted against the Dodd-Frank Act, has introduced a bill that would impose an extraordinarily burdensome standard of cost-benefit analysis on federal regulators.[6] In announcing the bill, Senator Shelby was clearly focused on a much larger target, as he proclaimed that "American job creators are under siege from the Dodd-Frank Act."[7] It is thus clear that cost-benefit analysis is the Trojan Horse in the battle over financial reform:

> But the string of court challenges, and Shelby's bill, are not really about cost-benefit analysis at all in the narrow sense. The standard they seek to enforce would be impossible to meet. As Geithner observed, **the unstated aim is to beat back federal regulation.**[8]

Finally, too often cost-benefit analysis is portrayed as the only acceptable form of economic analysis applicable to rulemaking. That is simply not the case. Cost-benefit analysis is too often inflexible, incomplete, inappropriate, and difficult to apply. But, that does not mean that **no** economic analysis can or should be performed by regulators. Indeed, as detailed below, Congress picks from a full spectrum of economic analysis options, from none whatsoever on one end, to a highly detailed and prescriptive cost-benefit analysis on the other. The Legislative and Executive Branches, working together in enacting and implementing laws, choose the level of analysis that they believe is appropriate for particular regulations and in light of particular objectives. For financial regulation, they have determined that a minimal economic analysis should apply, which prioritizes the public interest and the protection of investors, rather than an exhaustive cost-benefit analysis, which would interfere with the achievement of those policy goals.

Thus, cost-benefit analysis is not merely a neutral methodology that involves the mechanistic weighing of agreed upon costs and benefits. Instead, its use involves significant policy choices, implications, and outcomes. Indeed, although seemingly innocuous, cost-

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[6] Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (introduced Sept. 22, 2011).

[7] Press Release, *Shelby Introduces Financial Regulatory Responsibility* Act (Sept. 22, 2011), *available at* http://shelby.senate.gov/public/index.cfm/newsreleases?ID=df5330c4-80f7-479b-b6a3-c0b8e7d138be.

[8] John Kemp, *The Trojan Horse of cost-benefit analysis*, REUTERS, Jan. 3, 2012, http://blogs.reuters.com/great-debate/2012/01/03/the-trojan-horse-of-cost-benefit-analysis/.

benefit analysis has become a battlefield, where the war over financial reform is being waged. Following the "Executive Summary" below, the body of this Report analyzes that ongoing war, the SEC's very limited duty to consider the economic impact of its rules, and the appropriate holistic analysis actually required by the law.

Derivatives played a key role in the precipitating and transmitting the financial crisis and collapse; derivatives regulation is an essential part of the comprehensive financial reform aimed at protecting the American taxpayer from again having to bail out the financial industry

No one can deny that the unregulated and nontransparent derivatives markets, conducted almost entirely over the counter, were a central cause of the financial collapse and economic crisis that begin in the U.S. in 2007. As the ongoing Eurozone crisis shows, allowing major financial institutions to engage in derivatives activities of unknown amounts – with unseen risks, often even to the institutions themselves as well as the regulators and the public – can cause the entire financial system to collapse. As Warren Buffett has aptly noted, derivatives are "financial weapons of mass destruction."

They must be regulated and transparent. They must be moved from the dark over-the-counter markets to exchanges, ideally, or to clearing houses and execution facilities, at a minimum. Collateral and margin must be required, counterparty concentration must be limited, and trade reporting must convey meaningful information in real time. In addition, the product and entity definitions for "swaps" and "dealers" that trigger these new regulatory requirements must be broad and without loopholes. Further, rules implementing business conduct standards must be strong so that conflicts of interest and other abuses that destroy the integrity of the marketplace – and kill investor confidence in the markets – are limited to the maximum possible extent. Better Markets has commented on many facets of this new regulatory structure, which will now, for the first time, finally come into effect after the CFTC's and the SEC's recent passage of final rules on a further definition of "swap."

These reforms are going to cost money, but, contrary to self-interested claims, **they will not cost more** money than the current system. Currently, these costs are hidden, embedded, or shifted to society. The costs of risky, unregulated derivatives trading became apparent to everyone in the Fall of 2008, but those costs were shifted to society rather than borne by financial market participants. The financial reform and Wall Street re-regulation law shifts those costs back to the market participants, which is where they belong and which will reduce risky conduct the likelihood of future crises and bailouts.

End Users

The new requirements relating to margin in swap transactions perfectly illustrate the need to reallocate the costs of regulation – and the ability to do so without stifling the market. Many financial firms fought against this new approach. They claimed forcing derivatives to trade in the light of day on open exchanges would increase costs for commercial end users who rely on derivatives to manage their risks. What they didn't mention is that the supposedly "new" costs that end users would face from margin requirements (a transparent risk-management tool that Congress rightly determined should become the new norm) had really existed all along, but had simply always been embedded in the spreads they paid in the dark markets where end users had no way to determine what they were being charged or the ability to comparison shop regarding price or features.

For example, a business that uses an interest rate swap to trade a fixed rate for a floating rate might now have to put up initial margin of, say, 5% of the total value of the swap. This is to ensure that there is at least some cash on hand to cover losses in case interest rates move sharply against them. Previously, they may not have had to pay this 5% margin charge. But you can be sure they would have paid it elsewhere, embedded in the overall price of the swap, or in the spreads that the market offered them. In the past, the derivatives desk at a large dealer would simply have estimated the credit risk posed by a firm, and calculated a buffer that they would then add to the price of the swap.[9] This would be invisible to the end user, and also to regulators, but it was there nevertheless. Indeed, any trader who tried to avoid this step would have been fired on the spot. The problem was, this cost was entirely opaque, and there was no obligation on the part of the dealer to actually set the extra cash aside as a risk management buffer. Instead, it would just be treated as regular income and either used for other trading, or to pay bonuses.[10]

The new regime requires this hidden cost to be made explicit, and for the cash to be set aside as a genuine buffer against losses. This has been confusing to some end users, largely because some in the financial industry have misleadingly characterized this as a completely new cost. The analyses presented to end users by self-interested derivatives dealers not only ignored the previously embedded costs, but also assumed that all derivatives would now be subject to a uniformly high level of initial margin, with no netting. Thus, from a set of false assertions, they arrived at the entirely misleading conclusion that mandatory clearing would be costly to end users, when in fact it is quite the opposite. By bringing trading out into the open and requiring proper risk management, mandatory clearing greatly reduces the risk of another financial crisis.[11] The benefit of that reduced risk is, of course, enormous.

Moreover, transparency will enable end users to determine what they are being charged and for what. This will enable comparison shopping and, almost certainly, engender competition among providers. Of course, the big dealer banks that currently control the opaque over-the-counter markets do not want such transparency or competition.

Importantly, the financial reform law did recognize that there are some situations in which it might be advantageous for a commercial firm, such as a manufacturer, to trade a derivative off-exchange. Consequently, the law carved out a narrow exemption from the clearing mandate. The exemption applies to all bona fide end users, as well as small banks and financial institutions. It relieves them of the need to clear swaps and report them in real time.

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[9] *See* Better Markets Comment Letter "End User Exception to Mandatory Clearing of Swaps", February 22, 2011, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27992&SearchText=better%20markets.

[10] *See* Better Markets Comment Letter General Regulations and Derivatives Clearing Organizations, February 11, 2011, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27682&SearchText=, *see also* Mello, A. and Parsons, J., "Margins, Liquidity and the Cost of Hedging", May 2012, *available at* www.web.mit.edu/ceepr/www/publications/workingpapers/2012-005.pdf.

[11] *See* Better Markets Comment Letter "Trading Documentation and Margining Requirements under Section 4s of the CEA", November 4, 2011, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49931&SearchText=better%20markets.

Instead, whenever a commercial firm uses a swap to hedge its commercial risks, it will now be able to employ a simple check-the-box form, which will allow reporting with the minimum of burden. Margin payments will not be required, and end users will be free to negotiate their own bilateral risk-mitigation methods, as in the past.

Thus, end users are not subject to most of the new derivatives regulations that are designed to reduce systemic risk. At the same time, they will benefit hugely from the requirements placed on large financial swap dealers and participants. These large banks, hedge funds, and other traders are now required to clear their swaps, with adequate margin and full transparency. They are also required to employ business conduct standards in their dealings with end users. The combination of the Swap Dealer/Major Swap Participant rules and the End User Exception rule ensures that end users will be safer in the derivatives marketplace without being subjected to any burdensome regulations.

Bone fide commercial end users have a very strong interest in this process because they will be hurt the most if big financial firms and dealer banks are allowed to sneak into this narrow exception by claiming they are commercial end users when they are not. If they are allowed to do that, bone fide commercial end users will be hurt the most and not just because there will be less transparency and greater systemic risk. This will also almost certainly raise prices for bone fide commercial end users and enable manipulation of the markets to the detriment of end users. That is why the law has a narrow exception: to protect genuine end users, not big dealer banks and other financial players trying to hide behind bone fide commercial end users.

The Volcker Rule

The Volcker Rule prohibiting most proprietary trading and all but *de minimis* investments in hedge funds by banks that benefit from the federal financial safety net or are otherwise systemically significant is an essential reform. It effectively applies to only the biggest too big to fail banks because they are really the only ones that engage in any substantial proprietary trading or hedge fund investments. Moreover, while some continue to deny it, proprietary trading by those systemically significant financial institutions played a key role in the financial collapse and economic crisis.[12]

Proprietary trading is fundamentally no more than wild speculating by making huge leveraged bets with the banks' money for the purpose of hitting the jackpot and reaping an enormous windfall. Thus, this type of very high risk trading offers vast and fast wealth to those working for these too big to fail institutions. However, if those bets go wrong, as they did in 2007 and 2008, they can lose massive amounts of money very quickly and drag down

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[12] All these issues and more are addressed in four comment letters filed by Better Markets in response to the proposed Volcker Rule: November 5, 2010, *available at* http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1363; February 13, 2012, *available at* http://www.federalreserve.gov/SECRS/2012/March/20120309/R-1432/R-1432_021312_105537_519233431691_1.pdf; *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=57403&SearchText=; and June 19, 2012, *available at* http://www.sec.gov/comments/s7-41-11/s74111-594.pdf. The letters are referred to in the text by date.

an entire bank, which then has to be bailed out so it doesn't take down the entire financial system.

However, the law also carefully carves out certain permitted, socially desirable activities such as market making and risk-mitigating hedging. To avoid the big banks from disguising improper proprietary trading as a permitted activity (which they are highly incentivized to do given the gigantic bonus potential), the permitted activities are carefully defined. For example, permissible market making must be "designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties." The permitted activity of "risk-mitigating hedging" is also very carefully defined in the statute. Most of the industry's so-called concerns and objections to these definitions appear to be no more than attempts to create loopholes in the definitions of permitted activities so that they can continue their high-risk, but lucrative, proprietary trading.

Reinforcing the ban on proprietary trading and ensuring that the permitted activities don't become such loopholes, the Volcker Rule also prohibits, among other things, any "transaction, class of transactions or activity ... if the transaction, class of transactions or activity ... would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies ...."

Thus, the recently reported trading by JP Morgan Chase's Chief Investment Office (CIO) in London (the so-called "London whale") almost certainly would have violated the letter and not just the spirit of the law and proposed Volcker Rule. First, given the enormous net gains (reportedly 25% of the bank's net income for 2010) and losses (now reported to be approaching $9 billion) arising from this trading activity, it cannot properly be described as "hedging." And, given the swings in net profits and losses, it cannot properly be characterized as "**risk-mitigating** hedging," which is the definition of the permitted activity. Moreover, it has been widely reported that JP Morgan's CEO personally transformed the CIO from a low-risk hedging operation into a "profit seeking" operation; real "risk-mitigating hedging" does not generate net profits, which is what the CEO reportedly structured and staffed the CIO operations to create. (While losses and profits may be generated, they should be largely offsetting, resulting in little net profit or loss.)

Moreover, the JP Morgan CIO's trading certainly involved "high-risk assets" and "high-risk trading strategies," which are also expressly prohibited by the law. This is proved not only by the net profits and losses generated, but also by the fact that the CIO had to wager vast amounts of money to create those profits and losses, reportedly involving hundreds of billions of dollars. The CIO had, by the CEO's admissions, more than $350 billion under its control and much of that was apparently bet by the "London Whale" seeking to make a big splash and get a huge bonus, if not other rewards. Proving the high-risk nature of these assets and trading strategies, they apparently involved relatively illiquid securities because the bank couldn't exit the investments in any reasonable period of time to minimize its losses.

As if all that wasn't enough to demonstrate beyond a doubt that JP Morgan's trading violated the law and rule, it is also the case – as the CEO himself has admitted – that those very high risks were unknown to the bank; the bank's CEO, CFO, and other executives; and risk and operational management.[13] The narrow permitted activity of "risk-mitigating hedging" cannot, by definition, occur by accident, which is why the proposed rule has detailed procedures to establish that such hedging is in fact risk mitigating and in fact bone fide (although, as set forth in Better Markets February 13, 2012 comment letter, those procedures need to be strengthened).

Thus, the incentives to engage in this high risk behavior are enormous and must be addressed directly, which Better Markets did in its comment letters by focusing on compensation. Moreover, we addressed with specificity the industry's complaints regarding their claim that the rule will reduce their ability to act as market makers for corporate bonds, i.e., the alleged liquidity concerns. In this regard, it is noteworthy that the industry did not provide information or data on their own purported inventories to show (rather than merely claim) how the proposed rule would impact liquidity.

They do rely on a paper by the consulting firm of Oliver Wyman. Given that the paper was purchased by SIFMA on behalf of the industry, it is no surprise that it agrees with SIFMA's and the industry's position on the Volcker Rule. Like their arguments, however, the paper is deeply flawed. Better Markets addressed these flaws in its comment letters (specifically in the April 16, 2012 and June 19, 2012 comment letters), but I will briefly address the primary flaw here: Oliver Wyman, without explanations or basis (and contrary to basic economics), assumed that there would be no new entrants into the business of market making if the biggest too big to fail banks stopped making markets as a result of the Volcker Rule (which itself is a highly dubious assumption because market making is an expressly permitted activity).

Specifically, the Oliver Wyman paper stated that "[w]e do not directly analyze a wide range of potential knock-on effects, including... [t]he potential replacement of some proportion of intermediation currently provided by Volcker-affected dealers by dealers not so affected." As set forth in our comments letters of February 13, 2012, April 30, 2012 and June 19, 2012 (referenced and cited above), there is, however, a great deal of historical and contemporary evidence that entry is the normal market response to profit opportunities like this, including recently in the corporate bond markets.

This should come as no surprise to anyone. After all, the big dealer banks are not nonprofit organizations and do not make markets for free. They do it to make money and because there is money to be made. If they don't make that money, other market participants will move into the business to reap the profits.

Frankly, most of the industry's other objections simply don't stand up under the most minimal scrutiny either. For example, they claim that it is almost impossible to distinguish between proprietary trading and market making or hedging. This is simply baseless. Such activities have been going on for decades if not centuries or more and there has not been any

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[13] Moreover, JP Morgan's CEO also, without detail or explanation, claimed that the London Whale trade "morphed" into something he "couldn't defend." It is hard to conclude that statement is anything other than an attempt to mislead because a trade or trades – as he well knows – do not "morph." They are not living organisms. People structure trades, put trades on, take them off, change them, and are supposed to authorize, supervise, and monitor them. Someone or some collection of people did all of that, even if it wasn't with the knowledge or consent of the CEO, CFO, or others.

evidence of widespread confusion over those activities..........until the Volcker rule banning proprietary trading was proposed.

Wall Street has some of the highest paid people in the world and many claim that they are the smartest people in the world, but all of a sudden they can't tell the difference between activities that have been distinguishable for years, decades and more? These are self-interested complaints that seek to get the law and the rules re-written in a way that would allow the biggest banks to continue their wildly lucrative proprietary trading by a different name (which is what JP Morgan Chase and its CEO were apparently trying to do with the London CIO operations). While that would increase Wall Street's profits, it would yet again risk a raid on taxpayer's pockets and it must not be allowed.

Cross-Border application of derivatives protections

One obvious lesson of the financial crisis is that we had to establish comprehensive regulation over the previously unregulated swaps market to create transparency, mitigate risk, and protect market participants from predatory behavior. If implemented in the right way, Title VII of the Dodd-Frank Act will do just that.

Less obvious but equally vital is ensuring that this regulatory framework applies to cross-border transactions that have an effect on U.S. markets and financial institutions - and ultimately U.S. taxpayers. It is no exaggeration to say that without taking this critical step, the entire regime put in place to protect taxpayers, the Treasury, financial system, and our economy from unregulated swaps markets will become largely meaningless. If given the opportunity, the financial industry will devise whatever corporate structures are necessary - including heavy reliance on foreign entities - to facilitate swap transactions without any compliance with Title VII. This must not be allowed to happen.

The sheer volume of overseas swaps activity by large U.S. banks is enormous, representing in some cases half of their swaps-derived revenue. We also know that such cross-border activity poses very real risks to U.S. institutions and markets, since a risk that infects one affiliate within a family of corporate entities can quickly spread throughout the organization and jeopardize the entire group.

Before, during, and since the financial crisis, we have seen case after case of foreign swaps activity causing massive losses to U.S. banks and even destabilizing our entire financial system:

- Ten years before the financial crisis, Long -Term Capital Management, based in Connecticut, nearly collapsed as a result of losses in a trillion-dollar swaps portfolio ran by a Cayman Islands affiliate;

- During the crisis, the epic failure of AIG was triggered when its subsidiary operating in London and routing trades though a French bank sustained huge losses on its portfolio of credit default swaps, requiring an $182 billion bailout by the U.S. taxpayers;

- And just two months ago, JP Morgan served up a fresh reminder that global trading activity directly affects domestic banks: JPMorgan's "Chief Investment Office," based on London, has sustained multi-billion dollar losses on swaps transactions, and the actual extent of the damage to the bank is still being calculated.

Mindful of the need to expand swaps regulation beyond just U.S. borders, Congress included not one but **two layers** of protection in the Dodd-Frank Act. The statute applies the Title VII provisions to activities outside the United States that "**have a direct and significant connection with activities in, or effect on, commerce of the United States,**" as well as foreign activities that "**contravene such rules . . . as are necessary or appropriate to prevent the evasion of any provision of this Act.**"

The CFTC has just released interpretive guidance to clarify the way the law will be applied to cross-border swaps transactions. Better Markets will be commenting on the proposal in the rulemaking process greater detail, but it is clear that the guidance must answer four especially important questions:

- Is the definition of "U.S. Person" sufficiently broad to ensure that all foreign branch offices, subsidiaries, and other affiliates of U.S. institutions are subjected to all the provisions of the law, regardless of the location or the nature of their counterparties?

- Are the registration criteria for non-U.S. Persons acting as dealers and major swap participants sufficiently strong and comprehensive?

- Will the "entity level" and "transaction level" requirements be applied to foreign transactions in a way that addresses all of the risks and abuses that may eventually affect U.S. financial institutions and markets?

- And, is the test for allowing non-U.S. dealers and major swap participants to satisfy Dodd-Frank Act requirements through "substituted compliance" sufficiently reliable to ensure that foreign regulatory regimes are truly comparable in form, substance and enforcement, and remain so?

On these issues, we see some encouraging provisions in the interpretive guidance, but we also have some concerns that we intend to raise with the CFTC. Unless the application of the law to foreign swaps activity with a nexus to the United States is truly robust, much of what the financial reform law sought to achieve by regulating derivatives will fail.

And, just as U.S. taxpayers had to put up $182 billion to bail out AIG from its London based swap activities, U.S. taxpayers will be on the hook again. That simply cannot be allowed.

<u>International Harmonization</u>

Even more challenging than regulating cross-border swap activity is harmonizing the standards that multiple foreign jurisdictions and international regulatory bodies might apply to financial market regulation. The goal is certainly worthwhile as a general proposition, and it takes on special importance in light of the CFTC's interpretive guidance on the regulation of cross-border swap transactions under the U.S. financial reform law. If done right, harmonization could (and should) enhance the CFTC's ability to make comparability determinations that respect principles of comity and regulatory efficiency, without compromising the overriding goals of investor and market protection.

It is critical, however, that any comparability determination ensure that foreign and international laws and regulations are in fact comparable in substance and enforcement and not just in form. Claimed international harmonization simply cannot be used as cover for a race-to-the-global-regulatory-bottom, where the U.S. lowers its standards or accepts weak, porous, or easy-to-evade laws and regulations in other countries.

The American people have already suffered from U.S. authorities being too accepting of foreign and international promises and agreements that look terrific on the books, but provide no protection in substance. False comfort is no comfort at all and should be summarily rejected. International comity and cooperation cannot be more important than enforcing the law, preventing too big to fail banks from evading U.S. law, and allowing risk to be shifted – again – back to U.S. taxpayers and the Treasury.

The statutory foundations for harmonization are in place, as Section 752(a) of the Dodd-Frank law requires the SEC and CFTC (and also the prudential regulators) to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation ... of swaps, security-based swaps, swap entities, and security-based swap entities" in order to "promote effective and consistent global regulation of swaps and security-based swaps." Most importantly, the law says that should be done only "as appropriate" and that means only if it in fact protects the U.S. national interests in preventing another financial collapse and economic crisis.

Thus, the law does not require international harmonization as an end in itself. The purpose is to "promote effective and consistent global regulation of swaps and security-based swaps." The key words are "**effective** and consistent" regulation. That is what the law requires and that is what regulators are mandated to achieve.

It is encouraging that the crucial first steps are already underway: taking stock of the current state of international regulation, initiating dialogue with international authorities, and entering MOUs that provide the broad templates for building consensus for "effective and consistent" financial regulation worldwide. For example—

- In accordance with Section 719(c) of the Dodd-Frank Act, the SEC and CFTC have completed and issued a joint study on international harmonization of swaps and SBS regulation. The report was released in January 2012 (www.sec.gov/news/studies/2012/sec-cftc-intlswapreg.pdf), and it lists the major market participants in each geographic area, the major contracts (including trading volumes, clearing volumes, and notional values), the methods for clearing swaps, and the systems used for setting margin.

- IOSCO has issued a report on central clearing requirements (https://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf).

- Various memoranda of understanding have been entered with foreign regulators (http://www.cftc.gov/international/memorandaofunderstanding/index.htm).

- CPSS (part of BIS) and IOSCO have issued a report on principles for financial market infrastructures (i.e. clearing, settlement, payment) (http://www.iss-mag.com/news-bytes/cpss-iosco-issue-new-standards-for-financial-ma).

- Regular "technical dialogues" are underway with regulators in Europe, Japan, Hong Kong, Singapore, and Canada.

- Perhaps most important, in 2009, the G20 nations agreed that: (i) OTC derivatives contracts should be reported to trade repositories; (ii) all standardized OTC derivatives contracts should be cleared through central counterparties and traded on exchanges or electronic trading platforms, where appropriate, by the end of 2012; and (iii) non-centrally cleared contracts should be subject to higher capital requirements.

However, notwithstanding these laudable goals and positive early steps, the process of harmonization must be approached with two exceedingly important caveats in mind.

First, as observed in the CFTC's recent interpretative guidance on the regulation of cross-border swaps transactions,

> "In line with the G20 commitment, much progress has been made to coordinate and harmonize international reform efforts, **but the pace of reform varies among jurisdictions and disparities in regulations remain due to differences in cultures, legal and political traditions, and financial systems."**

Thus, the U.S. must be patient and persistent with a complex international process. However, it must not and cannot subordinate enforcing its laws, promulgating its regulations, and protecting its people to that process. Indeed, that process may ultimately achieve imperfect results in other countries, but the U.S. cannot allow those outcomes here. The American people have suffered too much already.

As the effort to achieve harmonization moves forward, the financial regulators in the United States, including the CFTC and the SEC, must not waiver in their commitment to strong, clear, and rigorously enforced standards across the entire spectrum of financial regulation—from capital and margin requirements to antifraud provisions. Any deviation from this guiding principle would be counterproductive in fact and unacceptable in principle. Moreover, it would violate U.S. law.

As a practical matter, the argument that diluting our own regulatory standards to more closely parallel weaker standards in foreign jurisdictions has never been supported by any evidence, and this approach is neither necessary nor desirable. The argument in favor of such concessions tends to be yet another example of the financial industry's perpetual cry that good regulation is bad for business, but that simply has not been substantiated and it is not true. On the contrary, high regulatory standards foster confidence in financial markets, leading to more, rather than less robust participation.

Self-interested industry participants claiming that a robust and effective U.S. financial reform system will hurt competition, business, growth, and employment have no basis for their unsupported assertions. As set forth above, when Wall Street and the financial industry was most regulated, our country and that very industry enjoyed the greatest prosperity. And, history shows that when the financial industry is least regulated, it quickly engages in reckless behavior, causing financial and economic crises that inflict enormous damage to the very interests they claim to promote through de-regulation.

Harmonization should be pursued earnestly and in good faith, but not at the expense of what the law requires: protecting our financial markets, investors, and the American people from another devastating financial and economic crisis that has so gravely damaged our country and our people.

The CFTC is the only police force on the derivatives beat and it needs substantially more funding to protect the American people properly

Financial regulators are the Wall Street policemen. If the regulators are not funded, they won't have the personnel or technology to pass, implement, and enforce the laws, which are essential to protect investors and our capital markets. Without regulators - and adequately funded regulators - another major financial crisis is virtually certain.

Unfortunately, one of the key tactics of the opponents of financial reform is to deprive the financial regulators of the funding they need to carry out their new responsibilities. To make matters worse, once they have successfully prevented the agencies from having adequate resources to do their job, opponents then attack them for failing to do their job.

Those agencies - and most notably the CFTC - must be provided with significantly greater funding so that they can acquire the human resources and information technologies that are indispensable to effective oversight of our increasingly complex and data-driven financial markets. This is especially important now that the CFTC has primary responsibility for ensuring that derivatives do not - again - become weapons of financial destruction and blow up the American taxpayer and treasury.

Added to the CFTC's traditional responsibilities for regulating markets with about $40 trillion of notional value, they are now also responsible for markets with more than $300 trillion in notional value. They need a budget commensurate with the duty of policing markets with more than $340 trillion in notional value.

Consider the challenges facing the CFTC. In the decade leading up to passage of the Dodd-Frank Act, the CFTC faced a steadily increasing strain on its budget. From 2000 to 2009, the futures markets expanded dramatically, with the number of actively traded futures and options contracts increasing six-fold, and the dollar volume of trading in futures and options increasing four-fold. Yet the CFTC's resources failed to keep pace with that market expansion, as its staff actually contracted and its budget barely doubled in size over that ten-year period.

Now, as a result of the Dodd-Frank Act, the CFTC is facing an extraordinary challenge. In addition to its current oversight duties, the agency must now regulate a swaps marketplace that is eight times the size of the futures and options market—representing a domestic notional value of over $300 trillion. This new responsibility has already put the agency under enormous strain as it has struggled to propose and finalize dozens of complex rules under Title VII of the Dodd-Frank Act. Going forward, the CFTC will have the responsibility for—

- Overseeing the registration over 200 new market participants, ranging from swap dealers to swap execution facilities and swap data repositories;
- Reviewing new swap "products" under the provisions of Dodd-Frank that mandate clearing and exchange trading of designated swaps;
- Examining each market participant with sufficient thoroughness and frequency to ensure that each entity remains in compliance with the Title VII requirements;
- Collecting, sorting, and analyzing a tremendous wave of new data on swap transactions;
- Investigating and taking enforcement action against all market participants that violate the law – tasks that are essential if the new regulatory regime for swaps is to have any meaning.

All of these new challenges for the CFTC, added to its already significant responsibilities over futures and options, will require major increases in funding for the agency. And yet, for fiscal year 2012-2013, the Agriculture Subcommittee of the House Appropriations Committee actually **cut** the CFTC's budget by $25 million—more than 10%.

This funding level is clearly indefensible—indeed inexcusable. In reality, it represents another assault on regulatory reform. Having failed to prevent passage of the Dodd-Frank Act and derail the CFTC's rulemaking effort, opponents of reform seek to prevent regulators from implementing and enforcing the law by starving the CFTC of the funding it plainly needs. This tactic is not only unfair, it is profoundly unwise: Unless the CFTC and the other financial regulators have sufficient resources to regulate and oversee the swaps market effectively, our markets will remain far too vulnerable to the risky and abusive behaviors that spawned the last crisis and threaten a new one.

Testimony of Robert Pickel
Chief Executive Officer
International Swaps and Derivatives Association
Before the
US Senate Committee on Agriculture, Nutrition and Forestry
July 17, 2012

Chairwoman Stabenow, Ranking Member Roberts and Members of the Committee:

Thank you for the opportunity to testify today. In the two years since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, significant progress has been made in three important areas in building a safer, more transparent over-the-counter (OTC) derivatives market and a more robust financial system.

First, as discussed in greater detail below, OTC derivatives market participants have continued to work, in advance of the onset of the new regulatory framework, toward the goals of reducing counterparty credit risk and increasing regulatory transparency.

Second, US policymakers over the past two years have made significant progress in defining and implementing the new regulatory framework. The scale and scope of this undertaking is considerable, and within that context it is clear that much has been achieved.

Third, progress has also been made on an international level in understanding the need for regulatory frameworks to be consistent and coordinated across jurisdictions. This is essential to ensure a level playing field for financial markets and financial institutions and to avoid regulatory arbitrage.

While this progress is both real and significant, it is clear that in certain respects the process of implementing the new regulatory framework envisioned by Dodd-Frank has been problematic. It has, for example, taken longer than initially expected. Many rules and regulations have yet to be finalized. The inter-relationship of Dodd-Frank related regulations needs to be considered and assessed to avoid contradictory rulemakings. Similarly, the set of Dodd-Frank rules in the US needs to be calibrated against similar frameworks in other jurisdictions.

All of these issues are causing considerable confusion and uncertainty in the financial markets. This confusion imposes both direct and indirect costs on the financial institutions that are required to comply with them. The direct costs include the time and resources spent trying to understand and implement them. The indirect costs include the foregone financial activity to which firms might otherwise allocate their resources. Both of these costs have a real economic impact. And, regardless of the significant resources being devoted to compliance, it is highly likely that the industry, market utilities (e.g., clearinghouses and repositories) and the regulators will be unable to fully implement many provisions of the law within the requisite timeframe.

Two years after the passage of the Dodd-Frank Act, it is fair to step back and ask how and where we could accelerate its implementation. ISDA and our members would suggest four concrete steps that could lead to the most progress in the shortest timeframe with the fewest disruptions.

- First, the finalization and implementation of rulemakings should be prioritized to focus on those that are most systemically important;
- Second, the most systemically important rulemakings should be analyzed and assessed to ensure that their implementation is properly sequenced;
- Third, after the sequencing is completed, US regulators should work with their international counterparts to ensure consistency in substance and timing of the new regulations.
- Fourth, the agencies need to engage in a fulsome cost-benefit analysis that considers the impact of the new framework on financial institutions, corporations, market liquidity, and the economy.

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I would like to address each of my points in more detail. But before I do, it's important to state clearly: The International Swaps and Derivatives Association squarely supports financial regulatory reform that includes measures such as enhanced regulatory transparency and centralized clearing of standardized trades. What's more, we have worked actively and engaged constructively with policymakers in the US and around the world to achieve this goal.

This, indeed, is our mission: to foster safe and efficient derivatives markets for all users of derivatives products. ISDA has, for example, helped to significantly reduce credit and legal risk by developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions. The Association has also been a leader in promoting sound risk management practices and processes.

Today, ISDA has more than 830 members from 59 countries on six continents. These members include a broad range of OTC derivatives market participants: asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers, as well as global, international and regional banks.

About one-third of those members are based in the US, of which nearly half are end-users. This demonstrates two important points. First, the US is an important center of global derivatives activity, a fact borne out by statistics from the Bank for International Settlements that indicate that about a quarter of global interest rate derivatives activity occurs in the US. ISDA's own research indicates that virtually all Fortune 500 companies use derivatives to manage their risks. Second, ISDA's membership is diverse and includes a variety of market participants. The Association's broad market representation is further reflected by the number of non-dealer firms on our board of directors and their representation on key ISDA committees.

In summary, derivatives are an important part of the US financial system and they play an important role in the real economy for US companies.

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Because of the important role they play, international policymakers recognized during and since the financial crisis the importance of developing and implementing an appropriate regulatory framework for derivatives activity. Their fundamental policy approach, which is reflected in the Dodd-Frank Act, was articulated in the G-20 Pittsburgh Communique, which stated: "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by year end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

There are three major principles related to systemic risk espoused in the statement:

- Central clearing of standardized swaps;
- Trade reporting of all swaps; and
- Higher capital requirements for uncleared swaps.

While capital requirements are extremely important, they are principally the responsibility of the BIS Basel Committee and national banking supervisors. The first two principles, however, (central clearing and trade reporting) are clearly key drivers of the Dodd-Frank legislative effort. They are important steps in addressing and potentially mitigating systemic risk. Clearing can reduce counterparty credit risk by putting a well-capitalized institution able to absorb risk between derivatives counterparties. Trade reporting increases regulatory transparency, which enables supervisors to see and analyze exposures that may build up in the system.

In the years leading up to and since the passage of the Dodd-Frank Act, ISDA, the major dealers, buy-side institutions and other industry associations have worked collaboratively with global regulatory supervisors in both of these areas. The work begun as part of the "Voluntary Commitment" process overseen by the Federal Reserve Bank of New York serves as the foundation for the continuing progress made today.

We note that, currently, in advance of any legally-required clearing, over 50% of the interest rate swaps market is centrally cleared. More than 90% of new eligible credit and interest rate derivatives transacted between clearing house members are submitted for centrally clearing. The volume of uncleared interest rate swaps has declined 40% between 2007 and 2011.

ISDA and market participants have also established trade repositories for the different OTC derivatives asset classes. Trade repositories collect and maintain a database of OTC derivatives transactions, such databases being available to regulators at any time. As noted, they can play an important role in improving regulatory transparency by providing an unprecedented level of market and firm-wide risk exposures to the appropriate supervisors and regulators. ISDA has helped to establish repositories for interest rate, credit, equity and commodity swaps and the industry is also establishing one for foreign exchange swaps.

In these and other ways, we are demonstrating our long-standing commitment to build robust, stable financial markets. Our work is not done yet. Further progress lies ahead as the new regulatory framework for derivatives is implemented.

* * *

Progress in these areas is closely tied to the development and implementation of the new rules required under Dodd-Frank. We believe that, in order to achieve the most gains in the shortest timeframe with the fewest disruptions, that the rulemakings should be prioritized according to their systemic importance, that they be reviewed to ensure they are sequenced appropriately and that they are then harmonized with rules of other key jurisdictions. Each of these points is discussed in more detail below.

Prioritize Rulemakings

As noted above, laws, rules and regulations related to central clearing and trade reporting have the most important implications in terms of systemic risk reduction. It is therefore essential that resources be focused on these areas to ensure their implementation at the earliest possible date.

In particular, it is of primary importance that regulators first get the information they need to further implement Title VII of the Dodd-Frank Act through functioning trade repositories and effective regulatory reporting and related recordkeeping.

Functioning SDRs and effective regulatory reporting of swap transactions are prerequisites to an orderly transition to the Title VII regime. Once it begins to compile data across markets, entities and transactions, the CFTC will be well-positioned to determine which types or classes of transactions should become subject to mandatory clearing and in what order and how to implement and monitor compliance with business conduct and other swap dealer rules. As stated by the Financial Stability Board's OTC Derivatives Working Group in a recent report, "authorities need better data on liquidity to facilitate the evaluation of suitability of products for central clearing."

Following this stage, regulators could then turn to the second stage: phasing-in of mandatory clearing (in the same order as that suggested above for reporting) and mandatory compliance with margin and capital rules.

After the first two stages – which focus on systemic risk mitigation -- are complete, attention could then turn to issues of non-systemic importance, such as execution requirements and standards governing the business relationship between counterparties

Appropriate Sequencing of Rulemakings and Implementation

As the most important areas of rulemaking are prioritized, it will also be important to make sure these rulemakings occur in the appropriate sequence. There is an urgent need to avoid a rule-making and implementation schedule that contain contradictory or confusing deadlines. At the least, a more detailed and realistic timeline for both final and proposed rulemakings would assist in the planning and implantation process, by, among other things, allow market participants to allocate resources in the most efficient and effective manner.

For example, based solely on the current compliance schedule for CFTC rules that have been finalized to date, swap dealers and their counterparties may need to amend their swap trading relationship documentation three separate times between late September and the end of this year. In addition, unless compliance dates for rules that have been proposed (but not yet issued and published in final form) by the Commission are coordinated, swap dealers and their counterparties will be required to further amend the full inventory of their swap trading relationship documentation several times in 2013. This would significantly increase operational and legal risks in addition to raising costs and confusion for end-users. This is one of the numerous examples of the potential problems that could be caused by the current sequencing of rules.

Separately, many firms are currently facing structural decisions related to the implications of registering as "swap dealers," without knowing the details or requirements of such a decision. This problem is exacerbated further by the extraterritorial or cross-border guidance discussed in greater detail below, which, while only proposed, will have significant implications for firms doing business globally.

We recommend that, instead of "rolling implementation" of regulatory requirements, the regulators allow for a "look back" period once the full panoply of regulations are finalized, but not yet effective. That will allow for an assessment of the entire regulatory regime and for market participants and regulators to see how these rules interact. Such a review is vital to ensure the continued competiveness and liquidity of the US markets.

International Harmonization

The third step that is important to ensure a timely, efficient and successful implementation of the guiding principles behind the G20 statement and the Dodd-Frank Act is a consistent, harmonized regulatory framework across jurisdictions. The G-20 vision of a global market transitioning cooperatively to common regulation may stand, fall or be delayed by US regulators' position on extraterritorial application of the US version of that vision.

The G20 commitment was to "implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage." This is a vitally important consideration in the development of a robust and globally consistent regulatory framework.

Today, however, there are serious concerns about the differences in the substance and the timing of rules between key regulatory jurisdictions. There is a great deal of uncertainty among market participants with respect to whether, and how, to implement a new regulatory framework that may duplicate or conflict with that of their parent country. And perhaps more importantly, there are concerns about whether level paying fields will be maintained.

Recently, the CFTC released its proposed interpretive guidance and policy statement regarding the cross-border application of the swaps provisions of the Dodd-Frank Act ("ET Guidance"). While the proposed ET Guidance is a step forward in that it marks the beginning of the "official" public dialogue on the issue, it also raises significant concerns. These include inadequate coordination with the SEC on its companion cross-border release and with non-US regulators, an overly expansive interpretation of the extraterritorial application of Title VII, a vague approach to comparability determinations for non-US regulatory systems, lack of fair treatment of US market participants and the lack of any cost-benefit analysis for new rules.

Ultimately, these issues combine to threaten a level playing field by:

- imposing on US market participants a substantially earlier rollout of regulatory requirements which, rather than attracting customers, may by dint of added cost and complexity drive customers to foreign competitors not yet so burdened.

- subjecting the market as a whole to regulatory inconsistencies that require four pages of grid charts to fathom, and that are based on conflicting and shifting policy rationales.

- moving in advance of SEC clarification of its own extraterritorial jurisdiction, so creating the potential for inconsistency between the swap and security-based swap markets.

Separately, the CFTC's choice of informal policymaking without cost-benefit analysis will in effect slight the public and the CFTC, by forfeiting the opportunity for appropriate, full review. Due to the important nature of this subject matter, this proposal should be subject to formal rulemaking.

As noted, this proposed guidance is extremely broad, covering the activities of anyone, anywhere doing business as, or with, a "US Person." In the view of the CFTC, wherever a US person enters into a swap, Title VII applies. To be plain, if a US person, doing business overseas, were to enter into a swap with a non-US counterparty, even if neither were a swap dealer or major swap participant, numerous Title VII requirements would apply.

This regulatory regime proposed through the ET Guidance is unnecessarily complex and, in many instances inconsistent. The proposal segments the standards into "entity level" and "transaction level" requirements, the application of which may vary widely depending on an entity's status. For example, the definition of "US person" includes an entity having a US person as a direct or indirect owner that is responsible for the entity's liabilities. It is unclear if such definition captures simple owners or if the definition reaches owners with partner or guarantor liability. Yet a foreign affiliate guaranteed by a US person is not a US person under the Proposed Guidance. A non-US swap dealer affiliate of a US person that is not guaranteed by a US person is potentially entitled under the Proposed Guidance to substitute compliance with all entity-level requirements. An identically affiliated non-US swap dealer that is guaranteed by a US person may face special swap data reporting requirements, but otherwise also may be able to take advantage of substitute compliance.

This complexity extends to non-US persons that are unregistered counterparties guaranteed by US persons entering into transactions with non-US swap dealers or major swap participants.

Here, for example, the presence of a US guarantor of the non-swap dealer (who, of course, is responsible only for the liabilities of the counterparty) in a reversal of common regulatory logic subjects the guaranteed transactions to transaction level regulatory requirements even though the guarantor is not even a direct party to the transactions. However, such a guaranteed unregistered, non-US person in a transaction with another just like itself is free of these transaction level requirements. Arguably, there is some purpose for these distinctions, however, they are inconsistent with the G-20 goals of fair global regulatory uniformity.

The impact of the ET Guidance on non-US swap dealers doing business in the US is also likely to be adverse. Along with the ET Guidance, the CFTC proposes a 12-month exemption from many Title VII requirements for non-US swap dealers and major swap participants who register with the CFTC and submit a compliance plan indicating any comparability determinations that they will seek. The CFTC registration deadline is likely to be mid-September. Will regulation offering prospects of comparability be in place soon enough after that to allow time for CFTC review before expiration of the temporary exemption? We think that in many jurisdictions the answer is at best "maybe". In Europe, for example, although a package of derivatives regulation known as EMIR is scheduled to come into effect in January 2013, that date is uncertain. A second package of regulation, known as MIFID II is not expected to come into force until 2015. MIFID II will then require some degree of individual nation implementation (and hence variability). MIFID II will reach areas of regulation that will be germane in a comparability analysis.

Hong Kong, as an example of another important market jurisdiction, is intending to pass its new derivatives legislation by the end of 2012. "Public consultation" on regulations is intended to begin at the same time. The calendar for Singapore is similar. Hong Kong and Singapore are leaders in G-20 implementation in Asia. Nonetheless, it is by no means clear that these jurisdictions will be able to show an adequate basis for comparability by some reasonable point in 2013.

This potential lack of comparability means that non-US firms doing business in the US may be subject to ambiguous and duplicative requirements for the foreseeable future.

Will the Commission find well-intentioned foreign regulation shaped to G-20 requirements sufficient? This is unclear. Will foreign regulators join in heightened cooperation with the CFTC? This is unknown. Will foreign jurisdictions wish to shape their regulations to the CFTC's requirements? This is unlikely. We fear that the granular approach proposed by the CFTC for determining comparability will potentially force firms to comply with an overlapping multi-layered web of regulatory requirements.

In addition to the issues raised by disparate rules, the timing of final implementation is of significant concern. For example, even if the rules of all jurisdictions are closely aligned, business will migrate to jurisdictions implementing the new burdensome requirements on a more reasonable timeline and, once there, such business will be unlikely to return to the US in full force.

ISDA stresses that principles of restraint and regard for comity are vital in this context, with respect to non-US participants in US markets and with respect to the treatment of US participants in non-US markets. Disadvantaging non-US institutions and their US subsidiaries, through divergent capital requirements or otherwise, discourages non-US investment in US subsidiaries, which will have negative consequences for the broader economy. Such divergent treatment also creates the potential for retaliatory measures between jurisdictions, further reducing liquidity and competitiveness and creating fertile ground for regulatory arbitrage. This could put US firms and US markets at a disadvantage, including by discouraging continued growth and participation by non-US firms in US financial markets, thereby concentrating risk and liquidity in far fewer dealers.

Duplicative rules will raise costs, ultimately impacting the real economy, while not serving any regulatory goal. Conflict between regulatory approaches will lead to regulatory arbitrage and competitive advantage based not on better strategic decisions or more effective resource allocation, but on government fiat.

* * *

In conclusion, much progress has been made in our shared goal of reducing risk in and increasing the stability of the OTC derivatives markets. More work remains to be done, however, and we need to reach consensus on the most effective and efficient way to do this.

ISDA and our members believe that such an approach is feasible and desirable. It would be based on a prioritization of initiatives that most impact systemic risk; the appropriate sequencing of those initiatives; and international harmonization of those initiatives.

United States Senate
Committee on Agriculture, Nutrition, and Forestry

"Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later"

Larry Thompson
Managing Director and General Counsel
The Depository Trust & Clearing Corporation

July 17, 2012

Chairwoman Stabenow, Ranking Member Roberts, and Members of the Committee, thank you for inviting me today to testify at this hearing.

I am Larry Thompson, General Counsel of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is a participant-owned and governed cooperative that serves as the critical infrastructure for the U.S. capital markets as well as financial markets globally.

Through its subsidiaries and affiliates, DTCC provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities, mortgage-backed securities and money market instruments, and mutual funds and annuities. DTCC also provides services for a significant portion of the global over-the-counter ("OTC") derivatives market.

I appreciate the opportunity to testify this morning on the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") two years after its passage and to provide insight from our perspective as a critical infrastructure provider, particularly as it relates to Title VII and the role of swap data repositories ("SDRs") and Legal Entity Identifiers ("LEIs") in the new regulatory regime.

Introduction

The DFA requires that all derivatives transactions, whether cleared or uncleared, must be reported to newly created SDRs. Based on our experiences over the last several years in developing such reporting systems, this is the right policy, and I am happy to report to you the progress that has been made from our perspective. Although the actual DFA reporting will not technically begin until sometime in September, following the credit crisis, regulators globally and the public have had access to significant amounts of data, particularly in the credit default swap ("CDS") market. The availability and accessibility of this information has helped bring greater transparency to what was previously an opaque market.

These voluntary efforts that DTCC has pursued have given us insight into the importance of such data to regulators and the public. We have every expectation that the SDR system DTCC and others are developing will help provide regulators the information they need to manage systemic risk and provide market oversight.

DTCC's efforts to date have shown that transparency truly does represent an important first step in giving regulators the tools they need to better understand systemic risk and more effectively perform market surveillance and oversight functions. The next step involves regulators acquiring the analytical tools to red flag excessive risk-taking or other anomalies so they can take action quickly to prevent or mitigate systemic shocks to the financial system.

Against the backdrop of the sovereign debt crises, corporate failures, credit downgrades, and significant losses by financial institutions as a result of OTC derivatives transactions, data transparency in the CDS market achieved through voluntary industry reporting has helped ensure market stability during times of volatility and given supervisors and the public the ability to more fully understand risk concentrations and levels of exposure.

For example, when the Greek government restructured its government debt earlier this year, it did not trigger extreme volatility in the markets as the restructuring might have in the past because regulators and the public had access to reliable and comprehensive information regarding the extent of market exposure to Greek debt. This experience, along with several other similar incidents, illustrates the value of SDRs for regulatory oversight, systemic risk identification and mitigation, and increased transparency for market participants.

Voluntary Initiative Benefits Mandated Trade Reporting, Depth of Repository Information

DTCC's ability to provide transparency into OTC derivatives markets predates the adoption of the DFA and reflects extensive experience operating an efficient and effective voluntary model for a trade repository. Since 2006, DTCC has operated the Trade Information Warehouse ("TIW" or "Warehouse"), which serves as a centralized, comprehensive global electronic data repository containing detailed trade information for the CDS markets. Today, as a result of this voluntary industry initiative, the TIW holds more than 98 percent of all credit derivative transactions in the global marketplace, including approximately 2.3 million separate contracts with a gross total notional value of $27 trillion.

Since the start of the financial crisis in 2008, DTCC has been providing market transparency to regulators and the public on credit derivatives transactions by leveraging data held in the TIW. In November 2008, in response to mounting concerns and speculation regarding the size of the CDS market following the collapse of Lehman Brothers, DTCC began public aggregate reporting of the CDS open position inventory. Today, this reporting includes open positions and weekly volume turnover, providing aggregate information that is extremely beneficial to both the public and regulators in understanding the size and level of activity in the market.

Comprehensive global market information is published by DTCC and made available at no cost to regulators or the public each Wednesday on our public website, www.dtcc.com. The data is robust and includes, net market-wide exposures to each CDS index and index tranche, as well market-wide exposures to each of the top 1,000 individual corporate and governmental entities on which CDS are written (top 1000 ranked by size of exposure). This allows market participants, regulators and the public to assess risks on the basis of timely comprehensive data, enabling them to develop informed views of market activity.

The published data also details broad categories of market participants and their positions in relation to important areas of the market, such as overall exposure to sovereign debt, corporate debt and other sector categories. Of note, details that would disclose the identity of position holders are withheld from the public website. Had this global and sector-based market information been available and published in the run-up to the 2008 crisis, much of the exposure uncertainty that contributed to market instability at the time, at least in the CDS market, could have been mitigated.

Global Electronic Database for Regulators

DTCC launched a "Regulatory Portal" in January 2011 for efficient regulator access to more granular trade data, utilizing a set of principles established by a consortium of regulators globally that enabled data information sharing amongst them. The taskforce created by the Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO") on regulator access to data is now reviewing these principles. DTCC will continue to coordinate and cooperate with these global efforts regarding regulator access to data.

The Portal provides automated counterparty exposure reports, query capability for market and prudential supervisors and transaction data for central banks with aggregate report views by currency and concentration. The guidelines developed by regulators globally ensure they have access to position and detailed transaction data so long as they have authority over one of the parties to the trade or authority over the underlying reference entity.

The Portal provides an unprecedented degree of market transparency by giving authorities the type of granular data needed to protect against systemic risk and also contains pre-determined filters to limit access to only that data in which the regulator has an appropriate interest. Today, over 40 regulators worldwide are accessing the portal, including U.S., European, and Asian authorities as well as regulators from other regions.

The experience of the TIW and voluntary reporting reinforces that the Dodd-Frank Act provisions related to post-trade reporting of all swaps – cleared and uncleared – does, indeed, yield a wealth of actionable information for regulators and market participants and will help achieve the public policy goals of the Dodd-Frank Act regarding increased transparency into OTC derivatives markets.

Readiness to Meet DFA Reporting Requirements

DTCC is fully prepared to meet DFA reporting requirements and has been working to comply with the Act since it was adopted in July 2010. Over the past two years, DTCC's investment has grown from tens of millions to hundreds of millions of dollars as we work to extend our global services to support swap data reporting for all five OTC derivative asset classes – credit, interest rate, commodities, equity and foreign exchange ("FX").

This infrastructure has been designed to allow regulators to leverage these resources in their efforts to ensure a safe and sound financial system. Based on DTCC's experience with the TIW, the infrastructure has been developed with maximum flexibility so that it can evolve over time to meet the changing needs of regulators and the industry. As new data fields are needed or other information becomes available to support market surveillance, the infrastructure can evolve to accommodate new needs and different priorities.

Two DTCC subsidiaries have applied for registration with the Commodity Futures Trading Commission ("CFTC") to operate as a "Swap Data Repository" for all CFTC-regulated asset classes. In addition, and upon the completion of corresponding rules by the Securities and Exchange Commission ("SEC"), an application will be submitted to operate a security-based SDR. Building on existing reporting relationships with market participants and by leveraging DTCC's infrastructure, the DTCC SDRs are already testing for necessary connectivity and educating market participants on how to report trade data in compliance with the regulations and technological protocols.

Given both the extensive developmental experience and the significant technology investment already made in the infrastructure, these new SDRs will be fully operational in August for interest rate and credit swaps, well in advance of the first DFA reporting deadline now scheduled for mid-September 2012. In addition, these platforms have already completed back-loading a significant share of the pre-Dodd-Frank swaps, or historical swaps data, which is just as vital for regulatory oversight purposes.

Important Next Steps to Meeting DFA Timeframe

Last week, the CFTC and SEC adopted joint rules defining a "swap" and "security-based swap," which will result in certain rules becoming effective 60 days after publication in the Federal Register. Several weeks ago, the SEC released a proposed implementation framework with rules to be implemented by category. As Dodd-Frank implementation moves forward, there are several fundamental steps that must take place.

First, it is vital that rules are put in place by all regulators to begin the reporting and collection of the raw data. These rules relate to reporting obligations and the registration of SDRs. The inflow of transaction information can be used to inform decisions related to other rulemakings, such as clearing determinations and block trade sizes.

Second, regulators must have the appropriate tools to analyze the data for both systemic risk oversight purposes and to identify potential abusive or manipulative market behavior. Having the raw data is important, but unless regulators are equipped with the necessary resources to understand and analyze the data, the full benefits of reporting swap transactions will not be realized. It is critical, for reasons of both time and money, that regulators leverage the capabilities of existing infrastructures to develop the necessary tools needed to identify certain risky behaviors on an automated basis.

Readiness to Meet Global Reporting Requirements

Regulatory bodies globally have also been working to establish similar trade reporting requirements to those contained in the DFA. At the moment, harmonization between the U.S., Europe and Asia remains an uncertain work in progress, although supervisors continue to hold discussions seeking to find common ground to avoid the inappropriate extra-territorial reach of sovereign regulation.

During this time, DTCC is moving forward with plans to provide Trade Repository ("TR") services in Europe and across the Asian-Pacific region:

- Europe: DTCC is actively involved in discussions with the European Securities and Markets Authority ("ESMA") on Europe's transparency needs and is working to comply with newly-issued technical specifications.

- Japan: DTCC has established a legal entity in Japan which is going through the regulatory application process, and will launch a trade repository with the intent to meet Japan's Financial Services Agency (FSA) November 1, 2012, initial start date for reporting.

- Singapore: DTCC has announced plans to operate a global data center in Singapore and will look to register as a trade repository by the end of 2012.

- Hong Kong: DTCC is in discussions with officials to establish a system for trades to be reported through DTCC, serving as an industry "agent" to the local repository under development by the Hong Kong Monetary Authority ("HKMA").

Compliance with DFA Reporting Requirements

Complying with the DFA reporting regime is consistent with DTCC's philosophy to leverage data globally to enable regulators worldwide to view a single, aggregated data set. Based on the current system of voluntary reporting of CDS transactions to the TIW, DTCC has long envisioned compliance with the new trade reporting requirements to look similar to existing voluntary market reporting.

However, I must caution that as final decisions for the establishment of SDRs and TRs are reached, there is great concern among supervisors globally over the possibility of fragmenting data across multiple SDRs in multiple jurisdictions. It is critical during the implementation process of new reporting mandates that 1) the reported data is complete and accurate and 2) a system is developed that allows for data aggregation.

New regulations should allow market forces to converge and support centralization, which is necessary for regulators to have a complete view of the market and the ability to perform market oversight and data analysis. A successful example of such convergence is the creation of the TIW, a single place for the collection of CDS data, created with encouragement of regulators and the support of the industry.

If other systems were to develop that do not ensure aggregation, both the published and regulator-accessible data could fragment, inevitably leading to misleading reporting of exposures. Quite simply, if regulators globally can only see data from one or two jurisdictions, they cannot obtain a full picture of the market. And if a regulator cannot see the whole market, the regulator cannot see the potential for systemic risk. Data fragmentation would leave the expensive task to regulators of rebuilding the complex data aggregation and reporting mechanisms (including extra-territorial trades on locally-relevant underlying positions) that have already been created.

Systemic Risk Oversight of Financial Services Industry

The Dodd-Frank Act extends beyond the OTC swaps markets – as does DTCC's role in enhancing transparency and supporting risk mitigation in global financial markets. To help anticipate a future financial crisis, governments and regulatory communities first need complete, timely position and transaction information across all asset classes transacted by systemically important financial institutions and their counterparties around the world.

Regulators should consider requiring the financial services industry to populate data hubs for regulatory access and allow the regulators to focus on developing the necessary analytical tools and processes to interpret data. It is critical that regulators have a method to find early concentrations and imbalances and to detect systemic problems before risky concentrations build up in the system. As has already been demonstrated, existing infrastructures can be leveraged and new infrastructures can be created very quickly through industry collaboration.

One major concern for the Committee's consideration is that the public sector is not currently in the position to allocate scarce resources and the extensive time needed to develop data collection and reference data efforts like the legal entity identifier ("LEI") initiative. The industry should shoulder these costs, which would free up the public sector to make investments in developing analytical tools and performing their oversight responsibilities.

The public sector should issue standardization and normalization criteria and demand that the industry quickly meet the challenge. The industry has the tools to accomplish this work in the most efficient way possible by leveraging a handful of regulated data stores across all asset classes that already process transactions and hold positions, including exchanges and other marketplaces, depositories, repositories and clearinghouses and other self-regulatory organizations.

Using a few highly regulated and supervised data hubs for information collection and normalization allows the public sector to concentrate on analysis. Having the data without having the most effective technologies in place to interpret it minimizes its value.

Conclusion

Madame Chairwoman, over the last two years, a significant amount of time, resources, and energy has been invested in the DFA legislative and rule-writing process. With the finish line rapidly nearing, it is incumbent upon industry participants to work closely with Congress and regulators to ensure that the rules are adopted and implemented consistently with the statute and in a way to effectively identify and mitigate risks to the financial system. Ensuring access to comprehensive, accurate, and timely data, along with regulators having the tools to analyze this information, are vital to the success of these efforts.

Thank you for your time and attention this afternoon. I am happy to answer any questions that you may have.

QUESTIONS AND ANSWERS

JULY 17, 2012

Senate Committee on Agriculture, Nutrition & Forestry
Dodd Frank Two Years Later
Questions For The Record
July 17, 2012
Mr. Robert Cook

Chairwoman Debbie Stabenow

1) *The advent and adoption of high-frequency and algorithmic trading seems to have had a dramatic impact on the way markets operate.* ***Have you defined this kind of trading? Have you analyzed, closely, the impact of this trading on markets? Do regulators have enough information to assess that impact? If so, what is that impact?***

In January 2010, the SEC published a Concept Release on Equity Market Structure ("Market Structure Release") that addressed, among other things, high frequency trading ("HFT"). It noted that the term generally is used to refer to professional traders acting in a proprietary capacity (as contrasted with acting as agent on behalf of customers) that engage in strategies that generate a large number of trades on a daily basis. It then noted five characteristics often attributable to HFT firms: (1) the use of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders; (2) the use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant unhedged positions overnight).

The Market Structure Release did not attempt to articulate a single, precise definition that would cover all types of HFT, noting that the types of firms engaged in professional trading and the types of strategies they can employ can vary considerably. Stated another way, HFT is not a monolithic activity in which all firms behave in the same ways. Rather, the Market Structure Release focused on particular strategies and tools that may be used by proprietary firms and inquired whether these strategies and tools raised concerns that the SEC should address. The strategies discussed were passive market making, arbitrage, structural, and directional (including order anticipation and momentum ignition strategies). The tools discussed included co-location and trading center proprietary data feeds.

Comments on the Market Structure Release were sharply divided on questions related to HFT. SEC staff has closely analyzed these comments, as well as the sources of data that were cited in the comments. SEC staff has also followed the expanding body of academic papers that address HFT questions, which also reach varying conclusions as to its impact on the securities markets. In addition, the SEC co-hosted an international roundtable on equity market structures in October 2011. The roundtable included regulators from Europe, the Americas, Asia, and Australia, and HFT was one of the key topics on which regulators shared information and views.

At this point, the SEC has not reached any final conclusions of the impact of HFT. It has, however, taken a number of important steps to gather better information with which to sort through the varying views and to assess HFT. These include the adoption of a Large Trader Reporting Rule in 2011, which, among other things, will assist the SEC in obtaining useful information on firms that conduct a substantial amount of securities trading. For example, by the end of the year, the SEC will be able to obtain records of the trading activity of certain firms that engage in HFT strategies. The SEC also adopted a Consolidated Audit Trail Rule in 2012 that requires the national securities exchanges and the Financial Industry Regulatory Authority (FINRA) to submit a plan to establish a market-wide consolidated audit trail that would significantly enhance regulators' ability to monitor and analyze trading activity. In addition, the SEC recently signed a contract to obtain a sophisticated real-time order and trade data system. The system, which should be operative by the end of the year, will provide the SEC with the same speed, ease and reliability of data collection and analysis that is available to sophisticated market players (such as HFTs). The system will enable the SEC to quickly collect, store, aggregate, monitor, query, manipulate, and analyze equity and options data.

Finally, the SEC has included in its hiring efforts the goal of attracting personnel with quantitative and trading skillsets. These personnel will enhance the SEC's ability to use the new data tools effectively as they come on line.

2) *A goal of the Wall Street Reform Act was to mitigate systemic risk, and as a part of that, it promoted central clearing. I understand that the SEC is currently considering an exemption that would allow the CFTC to oversee accounts that comingle single-name Credit Default Swaps (products overseen by the SEC), with index Credit Default Swaps (products overseen by the CFTC), and put them into a single omnibus account overseen by the CFTC.* ***What is your timing on approving this rule?***

Facilitating portfolio margining of index CDS and single-name CDS (collectively, "CDS"), and other swaps and security-based swaps, is an important initiative. Portfolio margining of CDS can offer many benefits to investors and the markets, including promoting greater efficiencies in clearing by taking a more comprehensive view of an investor's portfolio. While there is currently no legal impediment to customer clearing of these instruments, customers may lack sufficient incentives to clear without the financial benefits of portfolio margining.

The SEC and the CFTC are currently considering two clearing agency petitions seeking exemptive relief to permit commingling and portfolio margining of cleared customer CDS positions. The petitions contain requests for relief related both to the activities of a clearing agency and its members that are dually registered as broker-dealers and futures commission merchants. Other clearing agencies have also expressed an interest in obtaining similar relief. The SEC staff is striving to complete our review of these requests in a timely and efficient manner, and has been engaged in multiple discussions with the clearing agencies, market intermediaries, and customers.

Facilitating portfolio margining for customer-owned CDS that operate under different regulatory regimes, however, requires careful consideration by both the SEC and CFTC staff. One issue under consideration is the extent to which customers of clearing members may benefit from the ability to select between the segregation requirements and customer protections afforded a securities account subject to the Securities Exchange Act of 1934 and the requirements and protections afforded a swap account subject to the Commodity Exchange Act. Another issue under consideration is how to guard against the creation of inappropriate incentives to compete for customer business by unduly lowering margining levels, and possible ways to address this concern.

The staffs of the SEC and the CFTC have been working closely together to consider these petitions and address the issues presented. The staff has made substantial progress in formulating a potential framework to permit portfolio margining of cleared customer CDS positions and hopes to be in a position to recommend a proposed framework for relief to the Commission in the near future.

3) *Prior to the financial crisis, the SEC made significant progress in adopting a rule that would have created a limited federal exemption for business brokers who act in limited roles as both intermediaries and advisors during the purchase and sale of existing small businesses. In 2006, the Commission issued a no-action letter granting enforcement relief to a small business broker who acted in a limited role during a business sale.* ***Small business development, which includes the purchase and sale of existing businesses, is paramount to developing a strong economic base. Has the SEC considered taking additional steps to codify this limited small business broker exemption? How soon could we expect this?***

The treatment of "business brokers" is a long-standing issue. Currently, a person that is in the business of effecting the sale of operating businesses through the sale of securities may be considered a "broker" within the meaning of Section 3(a)(4) of the Exchange Act, and may be required to register as a broker with the SEC pursuant to Section 15(a) of the Exchange Act. Numerous industry participants have indicated to us that the burdens associated with broker registration are impractical for business brokers, given the limited scope of their securities activities.

As the question states, in November 2006, the staff of the SEC's Division of Trading and Markets issued a no-action letter granting enforcement relief for business brokers. This letter identified a narrow range of activities in which an intermediary may engage without being required to register as a broker with the SEC. Many industry participants, however, have commented that the no-action letter is too narrow to provide meaningful relief.

Recognizing the long-standing issues relating to business brokers, and the calls for SEC action in this area, the staff in the Division of Trading and Markets are developing possible recommendations for Commission consideration, which, among other things, could include proposing a rule to codify an exemption for small business brokers from broker registration.

Ranking Member Pat Roberts

1) ***How will the SEC be able to coordinate its cross border/extraterritoriality rule with the CFTC if the CFTC does not issue a rule?***

Title VII of the Dodd-Frank Act calls for the CFTC and the SEC to consult and coordinate for the purposes of assuring regulatory consistency and comparability to the extent possible. Accordingly, since the Dodd-Frank Act was passed in July 2010, SEC staff has been engaged in ongoing discussions with CFTC staff regarding our respective approaches to implementing the provisions of Title VII. Because the focus of our consultation has been the practical effect of our approaches, we believe that consultation and coordination will be useful and help promote consistency even if the CFTC issues interpretive guidance and the SEC issues a rule.

Our efforts to coordinate regarding the cross-border application of Title VII are complicated by the fact that the Dodd-Frank Act included different statutory provisions for the cross-border application of the SEC's and the CFTC's requirements, contained in sections 772(b) and 722(d) of Title VII, respectively. Nonetheless, the SEC staff has been consulting with CFTC staff regarding our respective approaches to the cross-border application of Title VII. For example, SEC staff has met a number of times with staff of the CFTC to discuss our respective proposals concerning the cross-border application of Title VII. The meetings have included comparisons of our respective approaches to the registration and regulation of foreign entities engaged in cross-border swap and security-based swap transactions involving U.S. parties to determine where those approaches converge or diverge. In addition, we are carefully reviewing comments on the CFTC's proposal and will incorporate insights from them, as appropriate, into the SEC rulemaking process. Moreover, the two staffs will continue these discussions now that the CFTC has released its proposal and throughout the remainder of the process at both agencies, with the aim of harmonizing our respective approaches to the extent possible, given the differences in the relevant statutory language and other relevant considerations.

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Tuesday, July 17, 2012
Questions for the Record
Mr. Erickson

Chairwoman Debbie Stabenow

1) What do you see as the most significant differences between U.S. financial regulations and coming international regulations and how could those rules impact the markets and the safety and soundness of our financial markets, market participants, and the U.S. economy?

Response: While international regulators have pledged to harmonize regulatory requirements for derivatives markets, few regulations have been implemented to truly test the strength of the commitments or assess whether they create an environment of regulatory arbitrage. The appropriate level of regulatory harmonization and a level playing field for US markets relative to other jurisdictions should be key guiding concepts to bear in mind as regulatory agencies proceed with their international regulatory coordination activities.

The Commodity Markets Council (CMC) supports the regulatory objectives of regulating the swaps marketplace, however, CMC members believe the U.S. Commodity Futures Trading Commission's rules to date may encourage regulatory arbitrage that would not only challenge US markets, but also open opportunities for growth in foreign markets. More specifically, the CFTC rules have tended to focus on increasing the regulatory burdens of the previously regulated market, most significantly on the commercial trade which had no part in the economic crisis that arose from failures in the OTC marketplace in 2008. By way of example, the CFTC continues to press for rules requiring the commercial trade to digitize and maintain recordings and data records for all cash market transactions agricultural firms have with farmers around the globe. While this smacks of regulating the cash market for which the CFTC has no direct jurisdiction, the more troubling aspect is that it suggests the Commission fails to understand that many U.S. futures contract markets serve as global benchmarks. Rules such as this will encourage the commercial trade to look for viable alternative markets.

Another example pertaining to commodity exchanges is the CFTC's so-called 85% rule, which would require at least 85 percent of a contract's trading to occur on an exchange's centralized market. This rule would have a chilling effect on the competitiveness of new exchanges and on new contracts, thereby putting American entities at a global competitive disadvantage.

We would also stress the importance of the recognition of comparable foreign regulatory regimes through mutual recognition and substituted compliance. The would serve the marketplace and market participants both by way of US entities being able to take advantage of the opportunities availed by international markets, and foreign entities from comparable regulatory regimes finding a welcoming US business regulatory climate when they expand their businesses to our shores.

Finally, to achieve maximum harmonization the CFTC must not only educate international policy makers about what to do, but more importantly about what not to do. Implementing a strong regulatory regime requires laser sharp focus on protecting the function of the market.

2) Recently, exchanges expanded their grain trading hours, which has raised concerns. We want to make sure the markets are serving those customers who are using the markets to hedge risk and that any changes don't unintentionally exacerbate price volatility. The USDA is considering whether to alter the timing of its crop report release. What do you think the expanded trading hours will do to the market and price volatility, and should the USDA change the timing of its report release?

Response: The CMC submitted comments to the USDA on its review of report release times and our comments are attached for the record in response to the question.

3) Can you comment on what your organization believes should be done in the wake of MF Global and the collapse of Peregrine Financial to better protect customers and their funds?

Response: The CMC membership strongly supports efforts to better protect customer funds. The CMC participated in the Senate Agriculture Committee's roundtable on MF Global where we identified guidance principles in assessing alternatives for better protecting customer funds. Those comments and principles are attached for the record in response to this question.

CMC
COMMODITY MARKETS COUNCIL

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Senate Committee on Agriculture, Nutrition & Forestry

Protecting Customers after MF Global

Perspectives from Market Participants

Tuesday, April 3, 2012
1:00-2:30pm

In November 2011, the Commodity Markets Council (CMC) convened a special task force composed of representatives from commercial firms, proprietary trading firms, financial firms, Futures Commission Merchants (FCMs) and self –regulatory organizations (SROs) to discuss issues related to the MF Global bankruptcy. We recognized immediately the impact this bankruptcy could have on our industry. The loss of customer segregated funds has shaken customer confidence and we believe it is paramount the industry, regulators, and policymakers work together to restore it.

Today I will offer the recommendations of CMC. These recommendations are similar to those we delivered in our testimony before the House Agriculture Committee in December 2011 but also reflect deeper deliberations as more information is made available.

Before getting into specific ideas, we believe three principles must inform the rule or law making process:

1. **Transparency coupled with adequate surveillance is generally good.** Transparency gives market participants access to information allowing them to make informed decisions while surveillance offer participants greater security that the protections embedded in the system are enforced.

2. **Fraud can be deterred but never eradicated.**

3. **Any proposed rule or law should undergo a robust and extensive cost/benefit analysis.** We believe the fundamental clearing system is strong and any proposed structural change should be seriously vetted before implementation.

Our Task Force compiled the following recommendations; however, at this time we are reluctant to endorse a policy recommendation that would fundamentally change the system. Instead, we believe that only after the investigation is complete will we be able to fully evaluate the matrix of solutions that may be required. With that in mind, our Task Force believes industry along with regulators and lawmakers should discuss the following ideas:

1. **Limiting to a fixed percentage the concentration risk ratio to a single issuer.**

2. Requiring customer accounts which exceed specified margin thresholds on an intra-day basis be funded through **direct wire transfer**, thereby ensuring intra-day margin calls are met.

3. Imposing **daily reporting of seg funds to Designated Self-Regulatory Organizations** (DSROs). This reporting should contain dollar amounts and valuations of the seg funds along with information about their maturity profile and other metrics (e.g. leverage earnings, capital ratios, etc.). Moreover, FCMs should provide DSROs with information describing their valuation

methodologies for all seg funds, with a view to ensure all seg funds are liquid and accurately valued.

4. Like many groups, including the National Futures Association (NFA), have recommended **increasing surveillance through auditing and unscheduled spot-checks**. We too believe this is something industry must consider moving forward.

5. To improve transparency and give market participants access to important information, we believe the **investment policies of FCMs should be available** to all potential and current customers. Moreover, such information should provide complete and relevant disclosures and assist in due diligence activities, but without suffering from "information overload".

6. Requiring FCM's to **report changes to a firm's investment allocations and profile for seg funds**, subject to reporting rules imposed by the CFTC.

7. We support the NFA's recommendation that an **FCM's CEO or CFO explicitly authorize any disbursement of seg funds from customer accounts that are not for a customer's benefit and are above 25 percent of the firm's excess seg**. We would also suggest that industry consider requiring an FCM's CEO or CFO to authorize any such disbursement that also exceeds 35 percent in one month.

8. Implementing a **formal system to train FCM staff** ensuring key personnel involved in the management of seg funds understand the rules protecting customer seg funds and the penalties for failure to comply. We believe other groups, including NFA and the Futures Industry Association, are also making a similar recommendation.

9. **Disallowing dually registered FCMs and Broker Dealers (BDs) from using the same funds to satisfy the net capital requirements applicable to both arms of the firm.**

10. Urging the **issuance of guidance by the Internal Revenue Service** for MF Global customers to clarify how customer losses should be reported for FY 2011.

CMC
COMMODITY MARKETS COUNCIL

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July 9, 2012

National Agricultural Statistics Service and
Office of the Chief Economist
US Department of Agriculture
1400 Independence Ave., SW
Room 5029
Washington, DC 20250

Re: ***Notice of Opportunity to Submit Comment on the Public Release Time of Several Major USDA Statistical Reports***
FR Doc. 2012-13951

Dear Ms. Clark and Dr. Glauber,

In light of recent commodity trading developments, the Commodity Markets Council ("CMC") welcomes the opportunity to respond to your June 8, 2012, *Notice of Opportunity to Submit Comment on the Public Release Time of Several Major USDA Statistical Reports* ("Notice").

CMC is a trade association bringing together exchanges with their industry counterparts. The activities of our members represent the complete spectrum of commercial users of all futures markets including agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange, and the New York Mercantile Exchange. CMC is uniquely positioned to provide the consensus views of commercial end-users of derivatives exchanges and the exchange markets. Our comments below represent the collective view of CMC members.

CMC and its members are long-standing proponents of integrity and transparency in U.S. derivatives markets. The viability of these markets and their ability to serve the price discovery and risk management needs of their users is directly dependent on these principles. We understand for some data users the transparency provided by trading through the reports may not be well-received, but we also strongly believe all data users are better served by seeing the market volatility associated with report releases. Prior to the June 12 report release, the market responded to USDA reports but the volatility was captured in opaque markets or in private transactions.

Grain trading occurs around the clock on US exchanges. To ensure US Department of Agriculture (USDA) reports are released at a time when the maximum number of market participants can access the markets and can quickly access the key information in a timely fashion, we suggest two modifications:

1) shifting the timing of the release of the major statistical reports to 11:00am eastern time; and

2) including with the release a one-page summary highlighting the market sensitive data points.

We discuss these suggestions and others more thoroughly below in our specific responses to the six questions presented in the Notice.

1. What is your preferred time of day (EDT) for report release

11:00am EDT

2. Why is this time preferred?

By releasing the reports in late morning, USDA aligns report publication times with times of high commodity volume trading. This alignment allows transparent derivative markets to efficiently process the information and facilitate the price discovery function. A late morning timeframe reflects when electronic trading platforms are open at CME Group, ICE Futures US, Kansas City Board of Trade, and Minneapolis Grain Exchange. Futures and option floor trading is also available at this time at CME Group and Kansas City Board of Trade. Having the option pits open is of particular interest to agricultural producers who are active option traders.

Logistically, a late morning release also facilitates access for all domestic data users, especially for users in the Pacific Time Zone. For almost two decades, pacific coast data users had to access the reports at 5:30am PT. While a later release time may not be ideal for European data users, they are not disenfranchised as it shifts the release hour to 5:00pm CEST.

Under current trading hours, at least one US ag market is open every hour of the day. CMC maintains hope industry will reach an agreement to pause when key USDA reports are released. However, in the absence of such an agreement and with around-the-clock-trading, we believe USDA should use the following principles to guide its determination on when to release the reports:

1. Market Liquidity
2. Electronic Access
3. Accuracy

Market Liquidity
As we indicated above, we believe peak market liquidity would be found between 11:00-11:30am ET. At this time, all exchanges and all trading platforms are open and operational giving all market participants access to an open and transparent trading venue.

Electronic Access
Equal access to USDA data is critical to ensure all market participants are competing on a level playing field. We encourage USDA to evaluate its technical capacity to determine if there is a time when it can minimize the disparity in access across all data users.

We applaud the changes made by USDA in advance of the June 12 report release. Maximizing portal access should be a key consideration to the timing of report releases and its importance would only be more critical at a time when there is heightened uncertainty.

In addition we recommend USDA accompany its major statistical reports with a one-page summary highlighting the market sensitive updates. This document would presumably more easily accessible across various internet bandwidths and it would serve as a quick reference by interested data users.

Accuracy
Reporting agricultural data is complicated, especially as the industry undergoes tremendous changes. If USDA finds timing influences the accuracy of its major statistical reports, we highly recommend timing be shifted to maximize accuracy.

3. Who are the data users impacted by this recommended time change?

See our answer to question 2.

4. How will this change impact these data users?

See our answer to question 2.

5. How are the data used when received at the current release time?

USDA, World Agriculture Supply and Demand Estimates, and National Agricultural Statistics Service Updates are juxtaposed against prevailing trade expectations to determine if current price levels are accurately reflecting USDA's updated supply/demand and price forecasts.

6. Other comments

We also strongly suggest USDA release its major statistical crop reports as early in the month as possible.

Regards,

Christine Cochran
President

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Chairwoman Debbie Stabenow

1) The advent and adoption of high-frequency and algorithmic trading seems to have had a dramatic impact on the way markets operate. Have you defined this kind of trading? Have you analyzed closely the impact of this trading on markets? Do regulators have enough information to assess that impact? If so, what is that impact?

Response: The Commission has undertaken several initiatives in response to the increased speed and automation in the markets, including automated trading systems (ATSs) that use high-frequency trading strategies. Commission staff are developing a recommended concept release on market safeguards that will address a number of pre-trade risk controls, post-trade reports and system safeguards for exchanges and market participants. The measures considered in the concept release would be designed to reduce the risk of market disruption arising from erroneous orders and trades, improve the testing and supervision of ATS, and respond to the increased speed and automation of futures markets. The concept release will seek public comment to inform the Commission regarding next steps.

The Commission also is researching possible methods of better identifying trading algorithms in the regulatory trade data provided by exchanges to the Commission daily. Staffing goals for both the implementation of the Dodd-Frank Act and conducting pre-Dodd-Frank mandates include hiring new staff that possesses broad skills in data management and data analysis. Such staff would be used to surveil trading of ATSs and high-frequency traders.

2) Mr. Erickson raised concerns in his testimony that some commercial entities on both the buy and sell sides in certain energy and agricultural markets may be captured by the swap dealer definition. Given their lack of experience with regulation, they might opt to leave the market. He states in his testimony: "There will be a drying up of liquidity, particularly in smaller, more esoteric markets where the profit margins are not there for the large banks and the only entities willing to trade are those with physical market risk. By regulating these entities as Swap Dealers, the cost of hedging in the commercial space will go up." Do you share this concern?

In December 2010, the CFTC (jointly with the SEC) issued a proposed rulemaking to further define the term "swap dealer." The proposal noted that the Dodd-Frank Act defines a swap dealer in terms of whether a person engages in certain types of activities involving swaps. Specifically, the statutory definition encompasses an entity that holds itself out as a dealer in swaps, makes a market in swaps, regularly enters into swaps with counterparties as an ordinary course of business for its own account, or is commonly known in the trade as a dealer or market maker in swaps.

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The Dodd-Frank Act directs that the Commission exempt from the definition any entity that engages in a *de minimis* quantity of swap dealing. The proposed joint rule included a description of the factors and thresholds proposed to be used for determining the *de minimis* exemption to the swap dealer definition, and specifically requested that the public provide comments. Many commenters that responded to the proposal addressed the factors and thresholds that should be applied, as well as the application of the swap dealer definition. The Commission specifically requested that commenters provide detailed information related to the costs of compliance with related rulemakings.

On April 18, 2012, the Commissions acted to approve the final joint rule to further define the term "swap dealer." The number of entities required to register is uncertain and will depend on the decisions of businesses involved. The rule generally provides that a person shall not be deemed a swap dealer if its swap dealing activity over the preceding 12 months results in swap positions with an aggregate gross notional amount of no more than $3 billion (the joint proposed rule included a threshold of $100 million). The rule also provides for a phase-in of the de minimis threshold to facilitate orderly implementation of swap dealer requirements. During the phase-in period, the de minimis threshold is effectively $8 billion.

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.

Ranking Member Pat Roberts

1) We understand that some time ago the CFTC's inspector general was asked to issue a report reviewing the MF Global matter. Please advise this committee as to whether that report has been issued and if so, why not?

Response: The Office of the Inspector General has been asked to respond directly.

2) Please submit to the committee CFTC's budgeted (beginning of the year) and actual object class breakdown for salaries and expenses for each of the past five fiscal years (2007 to 2011).

Insert 1

INSERT 1

Object Class Category	FY 2007 Budget ($000)	FY 2007 Actual ($000)	FY 2007 Difference	FY 2008 Budget ($000)	FY 2008 Actual ($000)	FY 2008 Difference
11.1-11.8 Personnel Compensation	57,493	55,536	1,957	60,507	57,953	2,554
12.1 Personnel Benefits Civilian	14,807	13,841	966	15,884	14,396	1,488
13.0 Benefits/Former Employees	34	9	25	9	0	9
21.0 Travel & Transportation of Persons	1,411	1,145	266	1,391	1,418	(27)
22.0 Transportation of Things	88	48	40	88	37	51
23.2 Rental Payments to Others	11,878	11,942	(64)	12,635	11,610	1,025
23.3 Comm., Utilities & Miscellaneous	2,716	2,362	354	2,862	2,369	493
24.0 Printing & Reproduction	401	316	85	400	312	88
25.0 Other Services	7,374	11,086	(3,712)	11,144	16,705	(5,561)
26.0 Supplies & Materials	826	731	95	830	749	81
31.0 Equipment	887	541	346	5,390	5,549	(159)
32.0 Building/Fixed Equipment	66	10	56	51	66	(15)
42.0 Claims/Idemnities	0	0	-	75	2	73
99.0 Total, Obligations	**97,981**	**97,567**	**414**	**111,266**	**111,166**	**100**

Object Class Category	FY 2009 Budget ($000)	FY 2009 Actual ($000)	FY 2009 Difference	FY 2010 Budget ($000)	FY 2010 Actual ($000)	FY 2010 Difference	FY 2011 Budget ($000)	FY 2011 Est. Actual ($000)	FY 2011 Difference
11.1-11.8 Personnel Compensation	75,727	66,601	9,126	93,857	82,577	11,280	95,426	95,919	(493)
12.1 Personnel Benefits Civilian	20,450	17,093	3,357	25,183	23,164	2,019	27,898	27,336	562
13.0 Benefits/Former Employees	6	9	(3)	9	4	5	3	0	3
21.0 Travel & Transportation of Persons	1,571	2,029	(458)	2,344	1,999	345	2,162	1,319	843
22.0 Transportation of Things	100	81	19	100	55	45	72	76	(4)
23.2 Rental Payments to Others	4,429	13,077	(8,648)	13,311	12,632	679	16,549	17,610	(1,061)
23.3 Comm., Utilities & Miscellaneous	13,079	3,676	9,403	3,962	4,156	(194)	4,204	4,850	(646)
24.0 Printing & Reproduction	472	340	132	327	664	(337)	1,539	1,862	(323)
25.0 Other Services	21,301	23,153	(1,852)	25,181	30,910	(5,729)	43,527	47,209	(3,682)
26.0 Supplies & Materials	1,010	1,023	(13)	1,012	1,055	(43)	1,264	1,186	78
31.0 Equipment	6,849	12,916	(6,067)	3,131	7,422	(4,291)	7,126	4,803	2,323
32.0 Building/Fixed Equipment	1,006	5,785	(4,779)	383	3,685	(3,302)	2,500	0	2,500
42.0 Claims/Idemnities	0	0	-	0	25	(25)	0	0	-
99.0 Total, Obligations	**146,000**	**145,783**	**217**	**168,800**	**168,348**	**452**	**202,270**	**202,170**	**100**

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3) The CFTC's final position limits rule will be effective 60 days after the recently approved final rule defining the term "swap" is published in the Federal Register. However, the position limits rule is the subject of ongoing litigation. Will the CFTC require market participants to comply with the final position limits rule before the case has been adjudicated?

Response: The U.S. District Court for the District of Columbia issued an order vacating the final rule and remanding it to the Commission.

4) The position limits rule requires monthly reporting of daily cash positions when parties exceed the position limits. Is the CFTC willing to consider a "commercial reasonableness" standard to these submissions since many of the submitting companies have global operations whose products are in commerce around the clock and for which systems to track and monitor inventories to this degree may be difficult to implement within the 60 day window provided?

5) Would the CFTC consider implementing such a standard by rulemaking on its own or through an industry petition?

Response to questions 4 and 5: The Commission received a petition dated September 11, 2012, related to the reporting of daily cash positions. In response to the petition and questions from industry participants related to the implementation of Federal position limits, Commission staff has begun to develop appropriate guidance. The U.S. District Court for the District of Columbia issued an order vacating the final rule and remanding it to the Commission.

6) At the hearing you said that avoiding a cost benefit analysis was not one of your reasons for implementing your cross border/extraterritoriality rule as an "interpretative guidance" as opposed to pursuant to a formal rulemaking. Would you be willing to voluntarily undertake a cost-benefit analysis?

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

The Commission, consulting closely with the SEC, the Federal Reserve and the Treasury Department, issued proposed guidance interpreting this section of the law. The Commission also proposed in a separate release phased compliance for foreign swap dealers (including overseas affiliates of U.S. swap dealers) of certain requirements of Dodd-Frank swaps market reform. Such phased compliance would enable market participants to comply with the Dodd-Frank Act in an orderly fashion and allow time for the CFTC to receive and evaluate public comment on the cross-border interpretive guidance. The Commission's Global Markets Advisory Committee also addressed these matters in a

recent public meeting. The Commission looks forward to reviewing all comments submitted including those related to costs.

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. For rules implementing Dodd-Frank reform, as well as the Commission's proposed interpretive guidance, the requirements of section 15(a) were applied.

<u>Senator Tom Harkin</u>

Accountability of Self-Regulatory Organizations

It is my understanding that a futures commission merchant does not have to carry a bond or insurance to protect its customers against losses, such as from fraud or malfeasance. An insurer or bond issuer would have a financial stake to protect and should therefore be strongly motivated to scrutinize very carefully the integrity, performance, and behavior of the firm whose obligations it is insuring or guaranteeing.

1) What does the National Futures Association and other futures industry self-regulators have at stake, financially or otherwise, in their oversight and enforcement of rules with respect to futures commission merchants, brokers, and other futures industry participants?

<u>Response</u>: Self-regulatory organizations (SROs) have specific obligations to ensure that futures commission merchants (FCMs) protect customers and their funds, and adhere to Commission and SRO regulations. Generally, the National Futures Association (NFA) performs the financial surveillance of FCMs that are not direct clearing members of a derivatives clearing organization (DCO) and clearinghouse SROs perform the financial surveillance of FCMs that are clearing member firms of a DCO.

The Commission oversees the SROs (both NFA and SROs that are part of designated contract markets (DCMs)) and has the authority to discipline, suspend or revoke an SRO's registration. This oversight serves as an important check. The entire purpose of the NFA is to help ensure that the markets are fair, efficient and safe for all participants. The Commission works with SROs and market participants in an effort to find the best methods to govern the futures markets in way that protects customers and instills confidence.

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Exchanges and DCOs have a direct financial stake in ensuring that the clearing member-FCMs do not experience financial losses from market events or other factors, including the misappropriation of funds, in proprietary or customer accounts. Such losses at an FCM that exceed the FCM's capital and other financial resources may present a financial risk to the DCOs.

The Commission has recently issued proposed rules to enhance the protections afforded customers that participate in the futures and swaps markets, including the protection of customer funds held by futures commission merchants and derivatives clearing organizations. The Commission looks forward to reviewing public comment on these important initiatives.

2) Does the CFTC have enough power and authority to ensure that industry self-regulatory organizations fulfill their responsibilities?

Response: The CFTC has comprehensive authority to oversee SRO functions and to bring disciplinary actions. The Commission's authority related to SROs include:

- **Requirement that FCMs and other intermediaries be registered with the NFA;**
- **Requirements that the SRO demonstrate that, in regulating the practices of its members, it will require adherence to regulatory requirements;**
- **Commission authority to abrogate association rules or to request that the futures association alter or supplement its rules;**
- **Requirement that the SROs police their members for fraud and misconduct and ensure compliance with requirements related to minimum capital levels and the segregation of customer funds; and**
- **Commission authority to suspend or revoke the registration of any registered futures association.**

An adequately funded CFTC is a good investment for the American public and would further ensure the integrity of markets.

Proposals for an Insurance Fund to Protect Futures Customers

It has been suggested that there perhaps ought to be an insurance fund for the protection of futures customers analogous to the Federal Deposit Insurance Corporation for bank depositors and the Securities Investor Protection Corporation for securities customers.

3) What are the main considerations and perspectives that in your view should go into judging whether such insurance should be established for futures customers?

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4) Has the CFTC examined the proposal for an insurance fund for futures customers, and if not, would you be willing to undertake an analysis of the proposal? (DSIO)

Response to questions 3 and 4: I am certainly open to an insurance fund, but recognize that the discussion will require a consideration of costs and benefits. As market participants and other stakeholders join Congress in considering the matter, I look forward to the discussion. In the meantime, I think we have to focus on everything that can be done to best protect the public with current authorities. To that end, the Commission looks forward to reviewing public comments on proposed rules to enhance customer protections.

Technology

5) Focusing on technology, what took so long for the National Futures Association, or the CFTC for that matter, to switch to electronic monitoring of customer segregated accounts?

6) It seems that technology should have been easily available for some time, so why wasn't this step taken sooner?

Response to questions 5 and 6: The Commission recently proposed amending its regulations to require entities holding customer funds to provide read-only direct electronic access to the Commission and to the FCMs' designated self-regulatory organization. Commission staff are consulting with depository institutions with regard to their ability to provide direct electronic access, particularly on a real-time basis. The SROs are continuing to work toward the goal of having all depositories provide the Commission and SROs with direct electronic access to account balances holding customer funds.

The Commission will continue to pursue the use of technology to enhance its oversight of how FCMs hold customer funds and comply with Commission segregation requirements.

Senator Saxby Chambliss

1) As the CFTC prepares to publish an initial list of swaps to be subject to the clearing mandate it appears that Europe will not be prepared to have any such clearing mandate in effect until 2013. What is the timing in Asia for an enforceable mandatory clearing requirement? What impact do you expect if the timing of the mandates is not coordinated?

Response: Regulators across the globe continue to work together towards achieving common goals including the G-20 agreement of September 2009 that: all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by the end of 2012 at the

latest; OTC derivative contracts should be reported to trade repositories; and non-centrally cleared contracts should be subject to higher capital requirements.

The Dodd-Frank Act fulfilled that agreement by calling for the movement of all standardized swaps into central clearing. The Commission has approved rules providing for the process of approving swaps under the clearing requirement. The Commission reviews the submission of a derivatives clearing organization (DCO) and determines whether the swap, or group, category, type, or class of swaps described in the submission is required to be cleared. The Commission has proposed a mandatory clearing requirement under those rules that would cover four classes of interest rate swaps and two classes of credit default swaps.

The CFTC continues to work closely with the European Union, Asian and Canadian jurisdictions with regard to financial regulatory reform, and in accordance with the requirements of the Dodd-Frank Act that the Commission consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to swap market regulation.

Regulators in Japan adopted legislation in May 2010 which mandates clearing of certain swaps. The Japan Financial Services Agency (JFSA) published a cabinet office ordinance, taking effect in November 2012, to require that certain index-based CDS and certain yen-denominated interest swaps be subject to mandatory clearing. The JFSA may expand its mandatory clearing coverage to include U.S. dollar- and euro-denominated interest rate swaps, as well as yen-denominated interest rate swaps referencing TIBOR.

The Securities and Futures Commission and Hong Kong Monetary Authority jointly released a consultation paper addressing mandatory clearing on October 17, 2011. This consultation plan described a phased implementation approach where clearing requirements will initially cover standardized interest rate swaps and non-deliverable forwards. Hong Kong regulators are working with their legislature to introduce a bill to the legislative council in coming months. Their published timetable anticipates that legislation will be fully implemented by mid-year 2013.

The Monetary Authority of Singapore (MAS) released a consultation paper addressing mandatory clearing on February 13, 2012. Based on a preliminary review, the MAS expects Singapore dollar interest rate swaps, U.S. dollar interest rate swaps, and Asian currency non-deliverable forwards to meet its proposed mandatory clearing criteria. Additional swaps will be considered for mandatory clearing via clearinghouse submission or upon the review of MAS.

According to a June 15, 2012, progress report issued by the Financial Stability Board (FSB), "[j]urisdictions now have much of the information they requested in order to make informed decisions on the appropriate legislation and regulations to achieve the end-2012

commitment to centrally clear all standardised OTC derivatives." The FSB urged all jurisdictions to work toward meeting the G-20 commitment to implement mandatory clearing by the end of 2012.

The Commission is working diligently to meet the G-20 commitment and fulfill the requirements of the Dodd-Frank Act. We continue to work with authorities from around the globe to ensure that our efforts are coordinated.

2) Chairman Gensler, earlier this month the CFTC released its guidance on cross border swaps. It allows for "substituted compliance" -- which seems to mean that US regulators will defer to home country regulators for entity-level requirements (like capital, risk management, CCO) where the home jurisdiction has comparable requirements. At the same time, the agency released an exemptive order extending the time for compliance with the entity level rules for 12 months following the registration compliance date. This order will evidently allow the CFTC time to determine which countries have comparable regulation. This new approach seems to ensure in a detailed way that foreign jurisdictions meet our standards for acceptable regulation and supervision. This new approach prompts a number of questions:

a) Is the "substituted compliance" concept essentially just going to require foreign jurisdictions to adopt US rules?

b) Will countries that follow principals versus a prescriptive approach to regulation be eligible for substituted compliance? Could substituted compliance be tantamount to fixing what's not broken?

<u>Response to questions 2(a) and 2(b)</u>: Under the proposed guidance, the CFTC would permit substituted compliance with certain Dodd-Frank requirements for non-U.S. swap dealers and major swap participants, allowing such entities to conduct business by complying with their home country regulations, if the CFTC finds that such requirements are comparable to analogous requirements under the Dodd-Frank Act. The Commission would retain discretion in its determination of whether to permit substituted compliance with foreign regulations. The agency would consider the scope and objectives of the relevant foreign regulatory requirements, the comprehensiveness of those requirements, the foreign regulator's supervisory compliance program, and the foreign regulator's authority to oversee the non-U.S. swap dealer or major swap participant. The CFTC may determine that the objectives of any program elements are met and thus permit compliance with the relevant foreign regulation, notwithstanding the fact that the foreign requirement may not be identical to that of the CFTC.

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c) How much more will it cost to analyze foreign regulatory regimes, and to monitor -- as the proposed Volcker Rule would require -- trading activities outside the US, including where US taxpayers may not be at risk?

Response: The Dodd-Frank Act requires that the CFTC, the Federal Reserve Board, the Securities and Exchange Commission, the Office of the Comptroller Currency, and the Federal Deposit Insurance Corporation to write regulations that implement the Volcker Rule. The CFTC and the other Agencies are in the process of evaluating and reviewing each of the comments that were received on the proposed Volcker Rule. The CFTC is aware of the concerns raised by commenters that the Volcker Rule may impose additional costs related to both (i) analyzing foreign regulatory regimes and (ii) monitoring trading activities outside the United States. The CFTC and the other Agencies are discussing these extra-territoriality issues, among others, as they work toward finalizing the Volcker Rule.

d) Do you perceive any unintended consequences -- like a movement of capital markets activity away from the US, leading to a higher cost of funding for US companies? Or new requirements imposed on U.S. banks by foreign countries which could be inconsistent with U.S. rules?

Response: The proposed Volcker Rule asked numerous questions on potential effects, including its impact on capital markets. In particular, the proposal sought public comment on effects on liquidity, efficiency, and price transparency. The CFTC and the other agencies are in the process of evaluating and reviewing the comments that were received on the proposed rule. Some commenters raised the concern that the proposed rule may result in unintended consequences, including the potential migration of capital markets activity away from the United States. The CFTC and the other agencies continue to examine public comments and to consult on the Volcker Rule's potential effects on US capital markets as we work toward a final rule.

Senate Agriculture Committee Hearing
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Tuesday, July 17, 2012
Post-hearing Question for the Record
Response of Mr. Dennis Kelleher
President and CEO
Better Markets, Inc.

To Chairwoman Debbie Stabenow

QUESTION 1) What do you see as the most significant differences between U.S. financial regulations and coming international regulations and how could those rules impact the markets and the safety and soundness of our financial markets, market participants, and the U.S. economy?

ANSWER: While it is impossible to know with certainty how financial market regulation in Europe and elsewhere will be finalized, the information currently available suggests at least five areas in which it is likely that international regulation will fall short of that in the United States. Those five areas are: Central Clearing of Derivatives, Pre-and Post-Trade Transparency, Position Limits, Resolution of Failed Institutions and Regulation of Large Financial Institutions. Below, I will discuss each of these in turn. But first, a brief discussion of recent history is in order to put into perspective the enormous importance of these areas of regulation and the impact they can have on the U.S. markets and economy. In addition, it is worth briefly reviewing two crucial contextual issues: cross-border application of derivatives regulation and international harmonization of financial regulation more generally.

The Linkages Between U.S. Markets and Overseas Markets in the 2008 crisis.

There is no genuine dispute that both the overseas operations of US firms and the market activities of firms headquartered outside of the United States were central to the last financial crisis.

AIG remains the prime example for the problems that arise from a major US based corporation that conducts significant operations overseas. As is well known, New York based-AIG ran its un-capitalized credit default swap ("CDS") business out of London, but the $180+ billion bill for its collapse was handed to the American taxpayer.[1] Less well known, but equally important, it has been revealed that over half of the AIG bailout funds eventually made their way to foreign banks.[2] Additionally, a GAO report determined that trillions of dollars of near zero-rate loans were made by the Federal Reserve Bank ("Fed") to foreign banks.[3] And it has been widely publicized that the single biggest borrower from the Fed's discount window at the height of the

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1 *See* GAO, Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance GAO-11-696, Jul 21, 2011 available at http://www.gao.gov/products/GAO-11-696.
2 http://www.businessweek.com/the_thread/economicsunbound/archives/2009/03/german_and_fren.html.
3 GAO, op. cit.

crisis in late October 2008 was Dexia, a Belgian bank.[4] This and other evidence makes it abundantly clear that U.S. corporate operations overseas and foreign financial institutions pose an immediate and substantial threat to the stability of the US financial system and economy.

There are many reasons for these transcontinental inter-linkages, but one of the primary causes is the vast opaque network of over the counter (OTC) derivatives that generated hugely complex streams of payments and obligations between different institutions with no transparency or regulatory oversight. The United States has set a strong example to the rest of the world in bringing these former shadow markets into the light. However, the rest of the world is lagging behind. Consequently, three of the areas I have identified as particularly significant in relation to international harmonization relate to derivatives.

Cross-Border application of derivatives regulations and international harmonization

The CFTC recently released interpretive guidance to clarify the way the law will be applied to cross-border swaps transactions. Better Markets will be commenting on the proposal in the rulemaking process greater detail, but it is clear that the guidance must answer four especially important questions:

- Is the definition of "U.S. Person" sufficiently broad to ensure that all foreign branch offices, subsidiaries, and other affiliates of U.S. institutions are subjected to all the provisions of the law, regardless of the location or the nature of their counterparties?

- Are the registration criteria for non-U.S. Persons acting as dealers and major swap participants sufficiently strong and comprehensive?

- Will the "entity level" and "transaction level" requirements be applied to foreign transactions in a way that addresses all of the risks and abuses that may eventually affect U.S. financial institutions and markets?

- And, is the test for allowing non-U.S. dealers and major swap participants to satisfy Dodd-Frank Act requirements through "substituted compliance" sufficiently reliable to ensure that foreign regulatory regimes are truly comparable in form, substance and enforcement, and remain so over time?

On these issues, we see some encouraging provisions in the interpretive guidance, but we also have some concerns that we intend to raise with the CFTC. Unless the application of the law to foreign swaps activity with a nexus to the United States is truly robust, much of what the financial reform law sought to achieve by regulating derivatives will fail. And, just as U.S. taxpayers had to put up $180+ billion to bail out AIG from its London based swap activities (and provide the other extraordinary emergency relief and bailouts to numerous other foreign firms and operations), U.S. taxpayers will be on the hook again. That simply cannot be allowed.

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[4] http://www.bloomberg.com/news/2011-03-31/belgium-s-dexia-drew-most-from-discount-window-during-record-week-in-2008.html.

Even more challenging than regulating cross-border swap activity is harmonizing the standards that multiple foreign jurisdictions and international regulatory bodies might apply to financial market regulation. The goal is certainly worthwhile as a general proposition, and it takes on special importance in light of the CFTC's interpretive guidance on the regulation of cross-border swap transactions under the U.S. financial reform law. If done right, harmonization could (and should) enhance the CFTC's ability to make comparability determinations that respect principles of comity and regulatory efficiency, without compromising the overriding goals of investor and market protection.

It is critical, however, that any comparability determination ensure that foreign and international laws and regulations are in fact comparable in substance and enforcement and not just in form. Claimed international harmonization simply cannot be used as cover for a race-to-the-global-regulatory-bottom, where the U.S. lowers its standards or accepts weak, porous, or easy-to-evade laws and regulations in other countries. International comity and cooperation cannot be more important than enforcing the law, preventing bailout-prone too big to fail banks and activities from evading U.S. law, and allowing risk to be shifted – again – back to U.S. taxpayers and the Treasury.

The statutory foundations for harmonization are in place, as Section 752(a) of the Dodd-Frank law requires the SEC and CFTC (and also the prudential regulators) to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation ... of swaps, security-based swaps, swap entities, and security-based swap entities" to "promote effective and consistent global regulation of swaps and security-based swaps." Most importantly, the law says that should be done only "as appropriate" and that means if – but only if -- it in fact protects the U.S. national interests in preventing another financial collapse and economic crisis.

Thus, the law does not require international harmonization as an end in itself. The purpose is to "promote effective and consistent global regulation of swaps and security-based swaps." The key words are "**effective** and consistent" regulation. That is what the law requires and that is what regulators are mandated to achieve.

With that in mind, the following are five areas that I see as being of primary importance in the context of differing international standards of regulation.

A. Clearing requirements

In the wake of the Lehman Brothers bankruptcy, counterparty credit concerns in the OTC derivatives markets brought payment flows to a freeze.[5] This turned the crisis global and systemic. To prevent a similar crisis of counterparty credit confidence, the G-20 resolved to bring the majority of derivatives onto exchange trading and central clearing by the end of 2012.[6] This would have the consequence that counterparties would no longer have to screen on another

[5] *See* Testimony of Michael Masters before Financial Crisis Inquiry Commission, June 30th *2010 available at* www.fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0630-Masters.pdf.

[6] http://www.financialstabilityboard.org/publications/r_120420a.pdf.

or speculate on creditworthiness, since margin payments to a central clearing party would ensure risks were managed centrally.

As of October 12th of this year, many of the key CFTC regulations pertaining to central clearing of derivatives will go into effect.[7] As a result, the first steps will have been taken toward ensuring a safer financial system for the United States. However, efforts in Europe are progressing at a much slower pace, and there are also signs that the clearing regimes abroad may be less robust than those at home. Fortunately, Congress had the foresight to mandate the CFTC to apply its swap dealer and major swap participant designations to any foreign firms with a "direct and significant" impact on US markets.[8] These designations carry with them various registration, risk management and mandatory clearing requirements. Similarly, the CFTC is empowered to regulate any individual transaction that meets the "direct and significant" test. While there is some pressure from foreign financial firms and sovereigns for the CFTC to adopt a light touch in this regard, any failure to fully carry out the legal requirements of the Dodd-Frank Act with respect to cross-border application of swaps regulations would impair the global efforts toward a safer derivatives market based on central clearing. This would needlessly and unacceptably put the U.S. financial system, its economy and taxpayers at risk yet again.

B. Pre-and post-trade transparency

The Dodd-Frank Act required the vast majority of derivatives to be brought onto transparent trading venues called Swap Execution Facilities (SEFs).[9] There has been intense lobbying pressure by some large swap dealers to weaken this requirement and allow less safe systems, which would be more profitable for the largest dealers but dangerous for the rest of the system and economy. These include request-for-quote (RFQ), voice brokerage and other systems that provide less than full transparency. The final rules on SEFs are not yet published, but in their initial proposals the CFTC appeared to hold a strong position, in line with the clear direction of the law.[10]

In Europe, on the other hand, lobbyists are attempting to include RFQ and voice brokerage at the legislative level, in the form of "organized trading facilities" (OTFs).[11] Should they succeed, this would lead to a two-tiered system, in which transparent pricing for derivatives would exist in the United States but not abroad. This could have either of two likely outcomes. First, it is possible that the United States will simply become the benchmark for derivatives transactions globally: international participants will see the US markets as the best-regulated and most transparent, and will consequently conduct most of their business here. The other possibility is that participants will flee to the darker markets, where they can accrue larger short-term profits but at the cost of greatly increased systemic risk and, therefore, also of future crisis.

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7 *See* http://www.pwc.com/en_US/us/financial-services/regulatory-services/publications/dodd-frank-swap-dealer-registration-date.jhtml

8 DFA §722 (d)

9 DFA §733

10 *See* http://bettermarkets.com/rulemaking/better-markets-comment-letter-core-principles-swap-exectuion-facilities

11 http://www.europolitics.info/business-competitiveness/mifid-mifir-trading-facility-sparks-debate-in-ep-art337466-8.html

The problem with this latter scenario of course is that such a future crisis would inevitably turn global, affecting the United States as well. Fortunately, Congress wisely included the "direct and significant" test on cross-border application of swaps regulation. Thus, if this language is properly implemented by the CFTC, it is likely that such a threat may be avoided. Nevertheless, it is to be hoped that the problem will be averted entirely by the Europeans and others passing appropriately strong regulation in the first place, as the G20 has called for.

C. Position Limits

One of the most insidious ways in which financial irresponsibility can damage the real economy is through the interplay between commodity derivatives and actual physical commodities. It is now well documented by academics and other researchers that commodity derivatives can and do distort the prices of food and energy commodities when they are allowed to trade without limitation. Speculative position limits are necessary to reduce or eliminate excess speculation on commodities so that markets serve the interest of actual producers and consumers, rather than being little more than gambling casinos for financial players.

The debate on position limits in Europe has been fierce, but the latest signs are that meaningful position limits will be put into place to mirror those already enacted in the U.S. This is yet more clear evidence that, if the U.S. sets a high but sensible standard of reform, then that the rest of the world will come up to it.

However, the battles continue to rage and some of the alternative proposals that are on the table are sufficiently worrying to warrant comment here. Specifically, there has been pressure from hedge funds and banks to implement a "position accountability regime," under which speculators with large positions would be required to explain the reasons behind their existence, to demonstrate they were not accrued with manipulative intent.[12] However, position limits do not just exist to prevent manipulation, they are also essential to eliminate excessive speculation. The CEA contains clear language to this effect: the CFTC *shall* impose position limits to "diminish, eliminate or prevent excessive speculation."[13] At present, no parallel language exists in the *pro forma* European regulations, although many civil society groups are pushing for it, as should U.S. regulators.

D. Resolution of failed institutions

Virtually every large contemporary financial institutions has numerous subsidiaries in foreign jurisdictions. For example, each of the seven most internationally active U.S. bank holding companies controls subsidiaries in at least forty countries.[14] As a consequence, when a transnational financial company fails it may be subject to conflicting bankruptcy or resolution

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12 *See* Finance Watch, "Investing Not Betting," April 2012 *available at* http://www.finance-watch.org/2012/04/investing-not-betting-download-finance-watchs-position-paper-on-mifid-2-2/

13 Commodity Exchange Act §4a(a)1

14 D. Avaraham et al. (2012). A Structural View of U.S. Bank Holding Companies, FRBNY Economic Policy Review, July, 2.

regimes. This was true when Lehman failed, and would likely be true for many of our large bank holding companies that operate swap dealers.

These legal conflicts present an obstacle to the effective use of the Orderly Liquidation Authority (OLA), which was created by Title II of the Dodd Frank Act. The OLA is designed to prevent the disorderly failure of a systemically important U.S. firm from inducing financial market panic, while removing the need to put taxpayer funds at risk while it is being resolved. When the Treasury, Federal Reserve and FDIC designate a failing financial firm for OLA resolution, it can be wound down by the FDIC in a manner that limits the impact of the failure on financial markets. Any costs to the FDIC will be recovered from other large financial firms.

However, for the OLA to function efficiently, the entire firm needs to be wound up in a consistent manner. This will require some coordination with the foreign jurisdictions in which U.S. firms operate. The FDIC and other regulators are currently negotiating memoranda of understanding with foreign jurisdictions to allow cooperation in the resolution of failed firms. The outcome of these negotiations will have important implications for long run U.S. financial stability.

E. Basel III and Dodd Frank regulation of large bank holding companies

Signatories to the Basel III Accord on bank regulation have taken divergent positions on whether that agreement constitutes a regulatory floor or regulatory ceiling. Switzerland, for example, has decided that its large banks should hold far more equity, relative to assets, than is required by the Accord. There has also been some discussion in Britain of requiring its banks to hold more equity than required under by the Accord. Other countries appear ready to adopt the Accord, but do no more.

The Federal Reserve, in the notice of proposed rulemaking that outlines its approach to section 165 of the Dodd Frank Act, has indicated that it will use the Accord as a regulatory ceiling.[15] This is not required by section 165, which gives the Federal Reserve wide discretion to determine capital ratios and establish other stability-enhancing requirements for large bank holding companies. If the Federal Reserve ultimately fails to reduce significantly the leverage of our large bank holding companies, our financial system will be remain vulnerable to financial shocks.[16] In this respect the U.S. will compare unfavorably to countries such as Switzerland that have adopted more stringent regulatory requirements.

Conclusion

We hope that this answer to your question is helpful to you and the Committee as you consider these important issues.

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[15] Federal Register, Volume 77, Number 3, January 5, 2012, 594-683..

[16] *See* http://www.bettermarkets.com/rulemaking/better-markets-comment-letter-enhanced-prudential-standards-and-early-remediation-require

Senate Committee on Agriculture, Nutrition & Forestry
Dodd Frank Two Years Later
Questions For The Record
July 17, 2012
Mr. Robert Pickel

Chairwoman Debbie Stabenow

1) What do you see as the most significant differences between U.S. financial regulations and coming international regulations and how could those rules impact the markets and the safety and soundness of our financial markets, market participants, and the U.S. economy?

Even before the Dodd-Frank Act was law, there was international consensus that only unified, consistent, international implementation of regulation could succeed in the global derivatives markets. This is clear from the declaration issued by the G-20, following the September 2009 Pittsburgh meeting. The Pittsburgh consensus is the recognized source of the primary goals of derivatives regulation that became embodied in vastly elaborated form in the US in the Dodd-Frank Act. The Pittsburgh meeting produced no mandate for unilateralism; the G-20 was designated by the leaders as "the premier forum for our international economic cooperation." The G-20 saw its mission as implementing "global standards in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage…"

It is vitally important to observe that the G-20 set only four goals with respect to derivatives regulation: clearing and exchange trading of standardized derivatives; reporting to trade repositories; and higher capital requirements for uncleared trades. Title VII of the Dodd-Frank Act goes far beyond the G-20 goals. Yet, the CFTC's Proposed Guidance regarding cross-border application of certain swaps provisions of the Commodity Exchange Act would require international imposition of virtually all of Title VII. This conflicts with the G-20 consensus approach and suggests that the US is essentially putting US market participants at competitive disadvantage in order to force the rest of the G-20 to follow the US lead in expanding derivatives regulation.

The timing of the CFTC's implementation also is inconsistent with the spirit of G-20. Although the G-20 suggested year-end 2012 as the date by which OTC derivatives goals were to be achieved, the Financial Stability Board created by the G-20 has noted that more time will be needed from a global perspective. It appears inconsistent for the CFTC to propose full domestic implementation by the end of 2012 and extraterritorial implementation by the end of 2013.

More specifically, some of the differences between US financial regulations and coming international regulations that are causing concerns include:

- First, the US headstart on the adoption of implementing rules means that a significant part of the US regime could be in force in advance of the corresponding EU rules. In the interest of competitive parity between US and non-US entities, ISDA recommends that the CFTC align the domestic and extraterritorial compliance dates of all requirements.

- The EU clearing regime is potentially less burdensome for end-users without any adverse systemic risk implications. In the US, the clearing obligation falls on everyone who trades an eligible contract, with a narrow exemption when non-financial entities enter into certain hedging transactions. In the EU, the clearing obligation only applies to transactions between financial counterparties, non-financial counterparties whose positions (excluding certain hedges) exceed a specified clearing threshold, and certain non-EU entities.

- In the area of data and trade reporting: current US trade reporting requirements apply to non-US counterparties. However, the application of local privacy and data protection laws generally depends on the nationality of the swap dealer's counterparty, making it difficult for them to comply. This issue could be alleviated by classifying SDR reporting such that it would apply only to counterparties that are US persons. Guaranteed non-US persons are not likely to be regarded as US nationals under applicable privacy laws and, accordingly, SDR reporting should not apply to them.

- While both regimes envisage registration and conduct of business rules for dealers (the EU already had rules under MiFID), the US regime also extends registration, conduct of business and margin/capital rules to major swap participants. EMIR only imposes clearing, reporting/record-keeping and margining and other risk mitigation rules (but not capital requirements) on non-financial counterparties whose positions exceed the clearing threshold.

- And lastly, both regimes seek to allow cross-border clearing by allowing the recognition/exemption of non-domestic CCPs. The US requires compliance with full US requirements and the EU makes recognition of non-EU repositories conditional on conclusion of a treaty.

2) What would the ramifications be if the process for setting LIBOR rates changed? Would it disrupt existing contracts and counterparty agreements?

ISDA believes the integrity of our financial markets is essential. ISDA supports efforts to enhance their safety and transparency and believes that fraud and malfeasance cannot be tolerated. The Association is aware that several regulators are arguing for LIBOR to be abandoned and a new rate based on executable prices be developed and/or used. ISDA understands the views that have been expressed on this issue. While we take no position on this issue, we will work with policymakers and market participants to fashion and implement an effective solution when a consensus emerges on the future of LIBOR.

The Association believes that the elimination of LIBOR, were it to occur, would not unduly impact existing over-the-counter (OTC) derivatives contracts. The 2006 ISDA Definitions provide the definitions of rate sources used in OTC derivatives transactions. These Definitions also provide a fallback alternative if one such rate source, such as LIBOR, is not published. The fallback essentially stipulates that the floating-rate rate source be determined by a poll of Reference Banks.

The Association also believes that any change in the formulation of LIBOR, were it to occur, would not affect the legal rights and obligations of counterparties to existing OTC derivatives transactions. As noted above, the 2006 ISDA Definitions provide the definitions of rate sources used in OTC derivatives transactions. These Definitions define a rate source in part according to the page and heading under which it appears on the screens of various Information Vendors that have created or published or provided the information that serves as the basis for the rates referred to in the 2006 Definitions. In most cases they do not specific a methodology for how the rate source is determined.

Ranking Member Pat Roberts

3) In your testimony you talk about the direct and indirect costs on financial institutions to comply with Dodd-Frank. Have you seen any analysis on what these costs are? Has anyone done a cost-benefit analysis?

The size and scope of the impact of Dodd-Frank on the financial system, financial market participants and end-users are to our knowledge unmeasured by the CFTC and SEC, as the agencies chose to pursue informal policymaking without a cost-benefit analysis. ISDA has stated on numerous occasions that the agencies need to engage in a fulsome cost-benefit analysis that considers the impact of the new framework on financial institutions, corporations, market liquidity, and the economy.

The industry has studied a number of key aspects of the new regulatory framework. This includes the costs of complying with the mandatory execution requirements of the DFA as well as the proposed rules on margin for uncleared swaps.

In November 2011 ISDA published an analysis of the impact of electronic execution requirements on over-the-counter (OTC) derivatives markets that were mandated by the Dodd-Frank Act. The paper, "Costs and Benefits of Mandatory Electronic Execution Requirements for Interest Rate Products," is available on the ISDA website: http://www2.isda.org/attachment/MzczMw==/ISDA%20Mandatory%20Electronic%20Execution%20Discussion%20Paper.pdf.

ISDA's study only addresses the electronic execution mandate, not the entirety of Dodd-Frank's effects. The ISDA study indicates that the mandate will, in all likelihood, bring little or no benefit to the market while adding significantly to the costs of using derivatives for end-users.

The paper found that:

- The electronic execution mandate and the proposed new regulatory framework will limit choice for end-users and ultimately increase transaction costs.

- The possible benefits for small end-users will be no more than $1,000 for a $10 million interest rate swap before fees for execution and clearing. Any net benefit for small end-users will be dramatically outweighed by costs to the market as a whole.

- Estimated initial set-up costs to market participants from the new rules are more than $750 million while ongoing costs are more than $250 million per annum.

- The initial and ongoing costs identified in the paper amount to approximately $1,300 per transaction. These costs, of course, do not currently exist in the marketplace.

- Derivatives users believe restrictive provisions in the proposed rules such as the 15 second rule, the requirement for at least five participants to quote through a request for quote (RFQ) platform, very high block trade thresholds and very short block trade reporting delays will negatively impact liquidity and push transaction costs up further.

As noted, there are also significant proposed margin requirements for non-cleared swaps and non-cleared security-based. ISDA estimates that collateral requirements created by the proposed margin rules for uncleared swaps by the Commission and Prudential Regulators may total as much as $1.0 trillion over several years if the rules are applied globally. This estimate does not include initial margin for any derivatives other than interest rate products but does include variation margin for all products.

ISDA estimates that the collateral requirements mentioned above ($1.0 trillion) would take effect over four or five years. The requirements would not grow linearly but may still amount to more than a hundred billion dollars in the first full year. Additional credit facilities or cash reserves would also need to be available for future margin calls. For an expanded discussion of this analysis, see Annex 1 of "ISDA and SIFMA's Comments regarding Margin and Capital Requirements for Covered Swap Entities":
http://www2.isda.org/attachment/MzI5Mg==/ISDA%20and%20SIFMA%20Comment%20Letter-Margin%20and%20Capital%20Requirements%20for%20Covered%20Swap%20Entities.pdf

In a separate study, the OCC estimated that the proposed rules would result in a collateral requirement of approximately $2 trillion. Their estimate is for initial margin only, but for all types of swaps. For interest rate swaps alone, the OCC's estimate of additional initial margin is $1.1 trillion. In addition, there may be a need for perhaps $250 billion of extra liquidity required for future variation margin calls. This increased collateral demand would arise as soon as new derivative contracts are executed unless new master agreements are executed to accommodate the proposed limitations on netting. In fact, hundreds of thousands of new master agreements would have to be executed just to prevent the immediate collateral consequences from occurring. The OCC study, "Unfunded Mandates Reform Act, Impact Analysis for Swaps Margin and Capital Rule", is available at: http://www.regulations.gov/#!documentDetail;D=OCC-2011-0008-0002.

4) What will be the economic impact of these capital and margin requirements when they take effect?

The economic impact of the new regulations, including the new margin and capital requirements, is difficult to assess prior to their finalization. Our study of the mandatory electronic execution requirement estimates that cost would exceed $1 billion in the first couple of years without any appreciate offsetting benefit. In terms of the margin requirement, one simple measure of its cost might be to assume a cost of 1% on the extra collateral required ($1 trillion) and half of that (or 50 basis points on the additional liquidity required ($250 million). This would amount to $11 billion per year once the rules are fully in effect. For an expanded discussion of this analysis, see Annex 1 of "ISDA and SIFMA's Comments regarding Margin and Capital Requirements for Covered Swap Entities":
http://www2.isda.org/attachment/MzI5Mg==/ISDA%20and%20SIFMA%20Comment%20Letter-Margin%20and%20Capital%20Requirements%20for%20Covered%20Swap%20Entities.pdf

The Basel III capital requirements, emerging from the Basel Committee for Banking Supervision, are also expected to have a significant impact. According to a study from the McKinsey & Company consultancy, the impact of the Basel requirements will be a €600 billion ($736 billion at August 10 rates) capital shortfall in the US banking sector. The gap in short-term liquidity is estimated at $700 billion (€570 billion), and the gap in long-term funding at $2.7 trillion (€2.2 trillion). These effects are separate from the capital requirements effects of Dodd-Frank. The McKinsey study can be found here on page 2:
http://www.mckinsey.com/clientservice/Financial_Services/Knowledge_Highlights/~/media/Reports/Financial_Services/Basel%20III%20and%20European%20banking%20FINAL.ashx

We believe the amount of additional collateral and capital requirements and liquidity drain would have an impact on financial markets and economies generally. Collateral and liquidity requirements, may force investors to sell assets, reduce the amount of derivative activity generally, and, thereby, reduce liquidity. It should be noted that the increase in collateral and the accompanying impact on liquidity cannot be analyzed in isolation and must be assessed in the context of increased capital charges and, potentially, increased liquidity requirements for banks, both of which will increase the cost of borrowing.

Senate Agriculture Committee Hearing
Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later
Tuesday, July 17, 2012
Questions for the Record
Mr. Larry Thompson

Chairwoman Debbie Stabenow

1) What do you see as the most significant differences between U.S. financial regulations and coming international regulations and how could those rules impact the markets and the safety and soundness of our financial markets, market participants, and the U.S. economy?

The most significant discordant note between the development of the U.S. financial regulatory system and global regulation is the lack of international harmonization of the developing rules. Financial derivatives markets are global in nature and the accompanying regulatory regimes must be implemented in such a way that regulators can perform systemic risk oversight across borders without infringing on the rights or responsibilities of cross-border regulators. This includes information sharing, swap data reporting, and access to data, both for regulators and the public.

One specific example that poses potential harm is the Dodd-Frank Act's indemnification provision in the data security section for swap data repositories. This provision is unnecessary and is unworkable in its current form. Without amendment to harmonize the intent of this section with global regulators, this provision will jeopardize the global swap data information sharing framework. The unintended consequence of getting this simple provision wrong, as has occurred in the Dodd-Frank Act, and not fixing it with a technical correction or elimination as proposed by H.R. 4325, is even less transparency and more opacity into derivatives markets.

Just as important as the substance of the rules is the timing of their enforcement. Regulators should be encouraged to work closely together with respect to implementation of their rules to prevent arbitrage opportunities or give certain jurisdictions a commercial advantage for being the last to put rules into place.

Finally, global regulators must apply their rules in consistent fashions. To ensure effective global regulation, jurisdictions must work together through international regulatory bodies like CPSS-IOSCO, the OTC Derivatives Regulators Forum (ODRF) and respect international principles of comity.

2) I would like you to comment more on the transparency measures in the Wall Street Reform Act. While the regulators and the public will have access to significantly more data, it won't be as useful unless it is aggregated and interpreted. What would you do as a Swap Data Repository to make the data more useful?

A swap data repository (SDR) will help provide regulators the information needed to manage systemic risk and provide market oversight. Specifically, the SDR will receive and maintain swap transaction data, ensuring that regulators and the public have accurate and timely data at all times. Congress recognized the need for all swaps market data to be reported to SDRs, requiring that cleared and uncleared swaps get reported. Having all swaps transactions reported to and maintained by SDRs will help to identify buildup of systemic risk and ensure regulators have a complete picture of the market.

To maximize SDR utility and provide detailed transparency into the market, all the information must be aggregated and netted and the regulators must have the necessary tools to analyze the data.

The core issue for consideration is really not about the act of data collection (as long as the data is ultimately aggregated and netted in one place), but is the data being reviewed and are there appropriate analytical measures in place that provide regulators early warnings to take appropriate actions to avoid or lessen a systemic event?

For example, DTCC's Global Trade Repository for Credit Default Swaps (CDS) holds aggregated and netted positions for over 98% of the global CDS traded. For each trade, over 130 separate data fields are collected. The challenge is not the collection or aggregation of the data by an SDR as the CDS repositories existence demonstrates. Rather, have the regulators identified early warning systems ("red flags") and key analytical measures for SDRs and Trade Repositories to populate among the data to identify potential systemic concerns prior to a negative event?

With respect to interpreting the aggregated data, regulators need to determine what data points are most relevant to their market and systemic risk oversight responsibilities and then execute the development and acquisition of analytical tools to "red flag" excessive risk-taking or other anomalies. This work can be done internally at the regulators or in partnership with the SDRs.

Currently, DTCC, through its CDS repository does this work with several regulators around the globe. However, SDRs and trade repositories are not regulatory entities, and are not in a position to define what information is crucial for a regulator to see as an early warning. While some systemic concentration may appear obvious when viewed after the event, forward looking analytics designed by and for regulators, in concert with private industry, is an appropriate effort that needs further emphasis.

As seen through recent events, including the Greek debt crisis, the collapse of Lehman Brothers, and others, some tools exist to both aggregate and interpret the wealth of information available to identify and mitigate systemic risk and provide increased transparency to the public. Much more effort and attention to this aspect of risk mitigation is needed.

3) The Wall Street Reform Act required that transactions be reported to regulators and to the public (for certain transactions) in real-time, or as soon as technologically practicable. How would you define real-time? What impact do you see the regulators' definitions of "real-time reporting" having on the market?

Although the statute and the regulations are clear that "real time" reporting is to be done when technologically practicable, it is becoming increasingly evident that the CFTC will require swap data repositories to have real time capability before going live with reporting services. While DTCC's DDR expects to be able to accomplish this goal, the costs associated with this evolving policy are very real.

It is important to remember that this "real-time" public dissemination will not take place until block trade thresholds are established and transactions cease being disseminated on a delayed basis. Initially, trades will be delayed 30 minutes before dissemination to accommodate the unpublished Block Trade rule.

A critical concern of the market participants in the establishment of real time reporting revolves around having sufficient procedures in place to protect intellectual property of unique trades. As with other aspects of public reporting, the appropriate balance between "getting it quick" and "getting it right" is critical to ensuring confidence in the market.

Senator Saxby Chambliss

1) Mr. Thompson, I understand from your testimony that much of the work on the reporting and collection rules is well underway, but I have concerns about whether the regulators have the right tools to analyze the data. How can we make sure regulators maximize the value of this data?

In order for regulators to be most effective, their focus needs to shift from data acquisition to acquiring the analytical tools to red flag excessive risk-taking or other anomalies. The Regulators should leverage existing private industry resources to build out the data warehouses and focus their activities on identifying the systems and procedures to "mine" that data in a manner that allows the ability to take action quickly to prevent or mitigate systemic shocks to the financial system. It is expensive and time consuming for regulators focus on building data collection systems, particularly when these capabilities already exist in the private sector.

The Trade Information Warehouse, an industry led initiatives, has been developed and improved over the last few years as a successful data collection model that could be used as a Swap Data Repository. The regulatory emphasis now should switch from data collection initiatives to designing and instructing analytical "red flags" that can be added to systems, such as the TIW, to better use the data already being collected.

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