HARMONIZING GLOBAL DERIVATIVES REFORM: IMPACT ON U.S. COMPETITIVENESS AND MARKET STABILITY

HEARING

BEFORE THE

SUBCOMMITTEE ON
GENERAL FARM COMMODITIES
AND RISK MANAGEMENT

OF THE

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HOUSE OF REPRESENTATIVES

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HARMONIZING GLOBAL DERIVATIVES REFORM: IMPACT ON U.S. COMPETITIVENESS AND MARKET STABILITY

WEDNESDAY, MAY 25, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 1300 of the Longworth House Office Building, Hon. K. Michael Conaway [Chairman of the Subcommittee] presiding.

Members present: Representatives Conaway, Neugebauer, Schmidt, Austin Scott of Georgia, Crawford, Huelskamp, Hultgren, Hartzler, Schilling, Lucas (*ex officio*), Boswell, McIntyre, Kissell, McGovern, David Scott of Georgia, Courtney, Welch, and Peterson (*ex officio*).

Staff present: Tamara Hinton, John Konya, Kevin Kramp, Ryan McKee, Matt Schertz, Debbie Smith, Heather Vaughan, Liz Friedlander, Clark Ogilvie, and Jamie Mitchell.

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

The CHAIRMAN. Again, thanks for everybody being here. Today we hold our fifth hearing to examine the implementation of the derivatives provisions within the Dodd-Frank Act. In previous hearings, many witnesses touched on international efforts to adopt derivatives regulatory reform and the impact such changes and regulation will have for the competitiveness of the U.S. and the stability of global financial markets.

In this morning's hearing we will explore the critical element to implementation: international reform and the importance of global coordination. Among many lessons, the financial crisis served as a severe reminder that instability can spread quickly through a global financial system.

Efforts to improve regulation of financial markets must be both cooperative and coordinated among nations. Assuring a coordinated and international regulatory approach is important to Members on both sides of the aisle and to stakeholders regardless of their size or role in the marketplace. Further ensuring we do not inadvertently place our own domestic financial system at a competitive disadvantage due to unnecessary cost and regulatory burdens should be a goal we must not lose sight of. Following the G20 commitment to adopt certain OTC derivatives reforms by the end of 2012, countries around the world began to craft their own proposals for derivatives reform. Both in timing and scope, the U.S. is far ahead of other nations in implementing these reforms.

Our position as we move first represents significant coordination challenges at home and abroad. By acting well ahead of other nations, we needlessly risk creating serious disadvantage to our own markets by failing to understand and prepare for the substance of international proposals that are far behind us.

Today it is my hope that we can explore certain critical issues for international harmonization. First, the impact of timing on the ability for the U.S. to coordinate with foreign regulators. As nations move at different speeds and with staggered effective dates, how will this impact coordination and the competitiveness of U.S. firms and markets?

Second, the impact on competitiveness of U.S. businesses. An overly narrow or limited approach to end-users exemption by U.S. regulators will increase costs and the reduce the ability of businesses across the country to manage risk. The question is how will a more flexible approach to the end-user exemption in the EU or elsewhere impact the competitive position of U.S. businesses *vis-à-vis* their international competitors.

Third, the implications for global coordination of inconsistent proposals among U.S. regulatory authorities. Consistency among proposals should begin first at home. The U.S. regulatory agencies to date have not demonstrated a high degree of coordination. The question is how will these inconsistencies among our domestic agencies' proposals impact the ability for the U.S. to coordinate with foreign regulators.

Fourth, the existing or potential differences between the U.S. and foreign proposals that will create opportunities for regulatory arbitrage. Market activity will invariably flow to geographical and financial sectors where the regulatory burden is lowest. Significant differences in regulatory proposals will lead to arbitrage and they will ultimately undermine the very market stability and transparencies these reforms were intended to promote. Where is the risk of arbitrage the greatest and are the U.S. regulatory—and what are the U.S. regulatory agencies doing to avoid divergence?

And finally, the reach of the Dodd-Frank in the U.S. into non-U.S. activities of global market participants. Just as markets are global, so are market participants. U.S. financial regulators have a history of recognizing and deferring to foreign regulatory regimes when registered entities engage in activities outside the U.S. Yet to date, significant uncertainty remains around the implication of Dodd-Frank internationally and recent proposals indicate that our regulatory agencies intend to take a different approach that is contrary to Congressional intent. The question is what will be the consequences of extraterritorial application of Dodd-Frank particularly for the competitiveness and viability of U.S. firms. At the end of the day, that should—today's hearing is about American competitiveness and ensuring U.S. businesses are not put at disadvantage that will inhibit their ability to create jobs and grow the economy. Without any shortage of issues to discuss, I look forward to hearing from our—today's witnesses.

[The prepared statement of Mr. Conaway follows:]

Prepared Statement of Hon. K. Michael Conaway, a Representative in Congress from Texas

Today, we hold our fifth hearing to examine the implementation of the derivatives provisions within the Dodd-Frank Act. In previous hearings, many witnesses touched on international efforts to adopt derivatives regulatory reform, and the impact such changes in regulation will have for the competitiveness of the U.S. and the stability of global financial markets. In this morning's hearing we will explore this critical element to implementation—international reform and the importance of global coordination.

Among many lessons, the financial crisis served as a severe reminder that instability can spread quickly through a global financial system and efforts to improve regulation of financial markets must be both cooperative and coordinated among nations. Ensuring a coordinated, international regulatory approach is important to Members on both sides of the aisle and to stakeholders regardless of size or role in the marketplace. Further, ensuring we do not inadvertently place our own domestic financial system at a competitive disadvantage due to unnecessary costs and regulatory burdens should be a goal we mustn't lose sight of.

Following the G20 commitment to adopt certain OTC derivatives reforms by the end of 2012, countries around the world began to craft their own proposals for derivatives reform. Both in timing and scope, the U.S. is far ahead of other nations in implementing these reforms. Our position as first-mover presents significant coordination challenges at home and abroad. By acting well ahead of other nations we needlessly risk creating serious disadvantages to our own markets by failing to understand and prepare for the substance of international proposals that are far behind us.

Today, it is my hope that we can explore some critical issues for international harmonization:

- **The impact of timing on the ability for the U.S. to coordinate with foreign regulators.** As nations move at different speeds and with staggered effective dates, how will this impact coordination and the competitiveness of U.S. firms and markets?
- **The impact on the competitiveness of American businesses.** An overly. narrow or limited approach to the end-user exemption by U.S. regulators will increase costs and reduce the ability of businesses across the country to manage risk. How would a more flexible approach to the end-user exemption in the EU or elsewhere impact the competitive position of U.S. businesses *vis-à-vis* their international competitors?
- **The implications for global coordination of inconsistent proposals among U.S. regulatory agencies.** Consistency among proposals should first begin at home. The U.S. regulatory agencies to date have not demonstrated a high degree of coordination. How will inconsistencies among our domestic agencies' proposals impact the ability for the U.S. to coordinate with foreign regulators?
- **Existing or potential differences between the U.S. and foreign proposals that will create opportunities for regulatory arbitrage.** Market activity will inevitably flow to geographical and financial sectors where the regulatory burden is lowest. Significant differences in regulatory proposals will lead to arbitrage and may well ultimately undermine the very market stability and transparency these reforms were intended to promote. Where is the risk of arbitrage greatest, and are the U.S. regulatory agencies doing enough to avoid divergence?
- **The reach of Dodd-Frank into non-U.S. activities of global market participants.** Just as markets are global, so are market participants. U.S. financial regulators have a history of recognizing and deferring to foreign regulatory regimes when registered entities engage in activities outside the U.S. Yet to date, significant uncertainty remains around the application of Dodd-Frank internationally, and recent proposals indicate our regulatory agencies intend to take a different approach that is contrary to Congressional intent. What would be the consequences of extraterritorial application of Dodd-Frank, particularly for the competitiveness and viability of U.S. firms?

At the end of the day, today's hearing is about American competitiveness, and ensuring U.S. businesses are not put at a disadvantage that will inhibit their ability to create jobs and grow the economy.

Without any shortage of issues to discuss, I look forward to hearing from today's witnesses.

The CHAIRMAN. Ranking Member Mr. Boswell, do you have a comment?

OPENING STATEMENT OF HON. LEONARD L. BOSWELL, A REPRESENTATIVE IN CONGRESS FROM IOWA

Mr. BOSWELL. Well, I do, and I want to thank you again, Mr. Chairman, for staying on the course to look at this. We have a lot of responsibility in ag and you have a major one with this Subcommittee, no question about it. And I have learned a lot. I want to say a couple comments, but I want to say to our witnesses, both of you, I don't know you personally, but I know something about your history.

I admire what you do. It is probably thankless. You both have to vote. You both have to participate and so I just appreciate you coming here and giving us the all sides, and what you think. Calling on your experience and all those things is extremely important to this country because, just for example, and I will say something in my comments here in a second, I have learned a lot.

I farm corn, soybean, cattle, hogs, that is kind of what I know about—the Chairman, the Ranking Member of the full Committee, and I. But I have learned a lot, for example, from Mr. Neugebauer and so on about cotton. Not why, because I am not a cotton farmer, but my best—one of my very best friends going to college and in our life, our flying experience—it just goes on and on and his two sons and my kids and so on—we have stayed that way.

I have learned a lot about cotton. But I know that when the price of cotton is good well, everybody says, "Look, there they go, forgetting the cost of inputs." And those days we had, those years we had those droughts—both of you guys know about this. Well, it is the same way with corn. You know everybody is all pumped up now, $7.00 corn, maybe more. Wow, look what is going on. They never mention what the cost of inputs are. Have you ever heard them talk about that?

They talk about gas, but I don't think there is hardly anybody that realizes what it has advanced to. The cost to produce a bushel of corn, costs about $6.00. And you know; that is not much margin. You think about the high cost of the capital investment to raise that bushel of corn. Risk is big. And so we need this kind of information. We need the pros and cons and everything whether it is—whatever it is.

So I just wanted to tell you that I personally admire you for serving on that Commission, both of you. Thank you. Now, the hearing today seeks to investigate the timing and coordination of derivatives oversight at home and globally. I understand they are concerned regarding global reform and the pace at which our G20 partners are addressing the problems that led to international market failure in 2008.

During the Pittsburgh Summit of 2009, the G20 nations agreed to adopt regulations that would create a framework to regulate over-the-counter derivatives and improve oversight and transparency of the domestic and international markets. I know that some here today will be commenting on extraterritorial jurisdiction and how market reform and the definition of a *swap execution facility* will affect subsidiaries and parent companies overseas. And we look forward to hearing your insight and working on these issues as we try to move forward.

A great deal of concern has been levied on global competitiveness, the effects of regulation, and the policy of U.S. companies and subsidiary branches here in our country. However, the Commissioners present today, you both note in your testimony there has been a great deal of coordination and consultation with foreign regulators. You have each called the proactive amount of consultation unprecedented.

And Commissioner Sommers, you note in your testimony at CFTC and the SEC staff engage in these discussions with the European Commissioners on a daily basis. I agree that we must work with our global partners on international policies for reform and I thank the Commissioners for your hard work in crafting rules and regulations. Thank you.

I also want to thank industry participants who have put in the time and the dedication to review these regulations and their effects on American business and market liquidity. So far I have been confident in what I have seen and heard from CFTC and the testimony submitted here that we are communicating with the G20 and moving in the right direction.

My opinions on implementation are not breaking news as I have expressed these sentiments toward our pace in OTC reform several times, I don't think we can slow down. An important agreement made among the G20 at the Pittsburgh Summit was much more than on international agreement. The decision to create effective reform to reduce systemic risk and enhance market stability is a promise that we made to American taxpayers, and we have a responsibility to make good on those promises. We must ensure our implementation provides harmony for all users and maintains the integrity of the marketplace for risk mitigation.

I remain committed to working with my colleagues in Congress to provide the CFTC with the tools and personnel needed to create successful reform. And I am disappointed that our colleagues on the Appropriations Committee have overlooked this in their current mark-up for the Fiscal Year 2012 funding.

Just in the last few hours, the CFTC did identify important work to all of us to protect not only market users, but also every American affected by the players who manipulate markets for their own financial gain. Just yesterday the CFTC charged several oil traders with purposely driving up the price of oil in order to make huge profits. This was done on the backs of our constituents not only at the pump, but at the grocery store, on the farm, small businesses—about every aspect of our life across the country.

In closing, I appreciate your contribution again to the investigation and increased transparency not only in our markets, but in this rule-making process and I look forward to hearing the testimonies and working with you to ensure fair and practical implementation with our global partners on behalf of the American taxpayers. Thank you very much. I look forward to what you have to say. Thank you, Mr. Chairman.

[The prepared statement of Mr. Boswell follows:]

PREPARED STATEMENT OF HON. LEONARD L. BOSWELL, A REPRESENTATIVE IN CONGRESS FROM IOWA

Thank you Chairman Conaway. I would like to thank our witnesses and everyone for joining us today as we review implementation of the Dodd-Frank Wall Street Reform Act and global derivatives reform.

The hearing today seeks to investigate the timing and coordination of derivatives oversight at home and globally. I understand that there are concerns regarding global reform and the pace at which our G20 partners are addressing the problems that led to international market failure when our nations met in 2009. During this meeting at the Pittsburgh Summit the G20 nations agreed to adopt regulations that would create a framework to regulate over-the-counter derivatives and improve oversight and transparency of domestic and international markets.

As well, I know that some here will be commenting on extraterritorial jurisdiction and how market reform and the definition of a swap execution facility will affect subsidiaries and parent companies overseas. I look forward to hearing your insight and working on these issues as we move forward.

A great deal of concern has been levied on global competitiveness, the effects of regulation and policy on U.S. companies and subsidiary branches here in our nation. However, at the same time, Commissioners Sommers and Chilton, you both note in your testimonies that there has been a great deal of coordination and consultation with foreign regulators. You each called the proactive amount of consultation "unprecedented" and Commissioner Sommers, you note in your testimony that CFTC and SEC staff engage in these discussions with the European Commission on a "daily" basis.

I agree that we must work with our global partners on international policies for reform and I thank the Commissioners for your hard work in crafting rules and regulations; I also want to thank industry participants who have put in the time and dedication to review these regulations and their effects on American business and market liquidity. However, so far, I remain confident in what I have seen and heard from CFTC and in the testimonies submitted that we are communicating with the G20 and moving in the right direction. My opinions on implementation are not breaking news as I have expressed these sentiments toward our pace of OTC reform several times: we must not slow down.

An important agreement made among the G20 at the Pittsburgh summit was much more than an international agreement. The decision to create effective reform to reduce systemic risk and enhance market stability is a promise we made to American taxpayers and we have the responsibility to make good on this promise. We must ensure our implementation provides harmony for all users and maintains the integrity of the marketplace for risk mitigation. *I remain committed to working with my colleagues in Congress to provide the CFTC with the tools and personnel needed to create successful reform and I am disappointed that our colleagues on the appropriating committee have overlooked this in their current mark for the Fiscal Year 2012 funding.*

As always, I appreciate your contribution to this investigation and increased transparency not only in our markets but in this process. I look forward to hearing the coming testimonies and working with you to ensure fair and practical implementation with our global partners on behalf of American taxpayers.

Thank you.

The CHAIRMAN. Thanks, Mr. Boswell. Our Ranking Member of the full Committee is with us. Mr. Peterson, you have comments you want to make?

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

Mr. PETERSON. Thank you, Mr. Chairman, and thank you, Mr. Boswell for holding this hearing and welcome to the Commissioners Chilton and Sommers, and I associate myself with Mr. Boswell's remarks. We appreciate the work you are doing.

It is important for us to have a thorough understanding of the steps that the CFTC is taking to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. As everybody knows, this Committee played the primary role in writing Title VII of this legislation with the goal of bringing greater transparency and accountability to the derivatives marketplace. And I think it is imperative that we make sure that the Commission is on track so I think the sharing is good.

Today we are looking into global derivatives reform and I still have some serious concerns that banks are once again trying to pit regulators against each other as part of their efforts to delay or even repeal financial reforms. When this Committee went to Europe for a week back—I think it was in December of 2009—probably the biggest thing we learned was that these big banks were telling the Europeans that if they regulated them they were going to move to the U.S. and they were telling the U.S. if they regulate them they were going to move to Europe.

Well now, I am hearing rumors that some of these big U.S. banks that operate over there as well are telling the European regulators that if that if they will not have as tough regulations as we have in the U.S., they will move their business to Europe. So it is kind of a preemptive strike in that case. So I am concerned about what is going on here. Apparently some of the other exchanges in Singapore and so forth are trying to lure people there. The whole idea, I guess, is to try to avoid any kind of regulation.

But the other thing that I am concerned about is that yesterday the House Appropriations Committee's Agriculture Appropriations Subcommittee marked up their work. And in page 55 of their bill, there is a limitation not to exceed $25,000 for expenses for consultations in meetings hosted by the Commission with foreign governmental and other regulatory officials. So if we are concerned about arbitrage and if we are concerned about getting these regulations in sync, why would we put a limitation on the Commission's ability to be able to meet with these folks? You know, this is kind of crazy.

So these are some of the concerns I have that—of what is going on here. So I would like some answers about what that provision is trying to accomplish. I also hope that today's witnesses will be able to shed some light on the issue of this supposed arbitrage between Europe and us.

In closing, I want to reiterate that while the rulemaking process so far may have not been perfect, I do not think that we need to hit the reset button and send the agency back to square one as some may like to see. Again, these are proposed, not final rules and I think we need to be patient and let the agency work through their process, and they are giving plenty of time to folks and they are having public input and so forth. And I just think if we delay this until December like some people want to do then we are just going to put more uncertainty into the situation not less. So I thank you, Mr. Chairman, for holding today's hearing and I look forward to hearing from our witnesses. I yield back.

[The prepared statement of Mr. Peterson follows:]

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

Good morning. Thank you Chairman Conaway and Ranking Member Boswell for holding today's hearing. And welcome, Commissioners Chilton and Sommers.

It is important for us to have a thorough understanding of the steps the CFTC is taking to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. This Committee played the primary role in writing Title VII of this legislation with the goal of bringing greater transparency and accountability to the derivatives marketplace. It is imperative that we make sure the Commission is on track.

Today we are looking into global derivatives reform. I have some serious concerns that banks are trying to pit foreign regulators against each other as part of their efforts to delay, or even repeal, financial reforms. I have heard that banks are still lobbying EU regulators to water down their proposed rules with the promise that they will move to Europe; then they turn around to lobby U.S. regulators with the same promises.

I hope today's witnesses will be able to shed some light on this issue.

In closing, I want to reiterate that while the rulemaking process so far may not be picture perfect, I do not think we need to hit the reset button and send the agency back to square one as some may like to see. Again, these are proposed, not final, rules. We need to be patient and let the agency work through their process.

Again, I thank the Chairman for holding today's hearing and look forward to hearing from our witnesses.

The CHAIRMAN. Thanks, Mr. Peterson. I appreciate that. The chair would ask that other Members submit their opening statements for the record so that our witnesses may begin their testimony.

Our first panel today are two Commissioners from the CFTC. I want to welcome them both here. We have the Honorable Jill Sommers, Commissioner, Commodity Futures Trading Commission, Washington, D.C.; and the Honorable Bart Chilton, Commissioner, Commodity Futures Trading Commission, Washington, D.C. Thank you both for coming. I appreciate the time you have put in getting ready for today. So Ms. Sommers, if you will start first, and then Mr. Chilton, we will go to you.

STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Ms. SOMMERS. Good morning Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee. Thank you for inviting me to today's hearing on harmonizing global derivatives reform: impact on U.S. competitiveness and market stability. I am Jill Sommers and I have worked in the derivatives industry for over 15 years and have been a Commissioner at the Commodity Futures Trading Commission since August of 2007. The views I present today are my own and not those of the Commission.

Over the past 10 months, the CFTC has been moving at a rapid pace to promulgate swaps rules included in the Dodd-Frank Act. Staff has been working closely with their counterparts at the Securities and Exchange Commission and other U.S. regulators and has been consulting closely and sharing draft rulemaking documents with regulators in the European Union, United Kingdom, Japan, Canada, and elsewhere.

Notably, staff has been communicating daily with European—with the European Commission to narrow differences on derivatives reform between our jurisdictions. This unprecedented level of cooperation has proven effective in aligning regulatory objectives and harmonizing most regulatory requirements. However, I am concerned that some important substantive differences between derivatives reform in the U.S. and in other jurisdictions do exist.

Other jurisdictions are not as far along in their reform process which may harm the global competitiveness of U.S. businesses, and our failure to clarify how our rules will apply internationally has created a great deal of uncertainty both in the U.S. and abroad. I would like to briefly address each one of those issues today.

At the G20 Summit convened in Pittsburgh in September of 2009, President Obama and other world leaders agreed that standardized OTC derivatives 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. Other jurisdictions are working to meet this end of 2012 deadline, but we are working to implement reform much sooner. I believe a material difference in the timing of rule implementation is likely to occur, which may shift business overseas as the cost of doing business in the U.S. increases and create other opportunities for regulatory arbitrage.

In Europe, legislation on clearing and reporting requirements for over-the-counter derivatives called the European Market Infrastructure Regulation or EMIR may not be finalized for weeks. Yesterday, the ECON Committee of the European Parliament adopted its report. The next phase of this process is for the Member States or Council to adopt a position and then the two bodies will work—excuse me—will work for an agreement on a common position. After adopting legislation, EMIR directs authorities to draft technical standards which may take close to a year.

While the timing differences on these specific reforms between the U.S. and the EU will depend in large part on how quickly we are able to finalize and implement rules at the Commission, there is even a greater disparity in timing between the U.S. and EU in implementing other reforms in the OTC derivatives market. Rules on mandatory trade execution and other provisions that are parallel to provisions in Dodd-Frank are being considered as part of a review of the EU's 2007 Markets and Financial Instruments Directive or MiFID. However, formal legislation has not been proposed and I am not certain that these reforms will be complete until 2012 at the earliest.

In Asia, Japan has passed its legislation and plans to implement reform by the end of 2012. Other jurisdictions such as Singapore, Australia, Hong Kong, and Korea are also either providing or planning to provide clearing services. At the CFTC, on the other hand, after 10 months, eight public round tables, 14 open Commission meetings, and more than 50 proposed rules, notices, or other requests seeking public comment, we have nearly completed the proposal stage of our rules and are moving forward with reviewing comments from the public in preparation for drafting and voting on final rules.

In order to do so effectively, however, I believe we must work at a more deliberate pace, not simply so that our timing is aligned with other jurisdictions, but so that we can thoroughly consider proposed rules to ensure that we get it right. Beyond timing, carefully tailoring these rules to address legitimate concerns from the public while upholding out statutory obligation is, I believe, a critical component of rulemaking. However, I feel these concerns may be addressed differently across jurisdictions.

For example, a provision in the EU's proposed legislation on clearing and reporting of OTC derivatives would explicitly exempt multilateral development banks such as the International Bank for Reconstruction and Development. Such organizations whose statutory mission is to combat poverty and foster economic development are not exempt under any of the Commission's proposed rules. And I believe this should be addressed.

As another example the EU is considering exempting pension funds from mandatory clearing of their swaps transactions while Dodd-Frank does not contemplate any such exemption. I am also deeply concerned that differences remain with respect to rules being considered at the Commission and in Europe for the mandatory execution of swaps on a trading platform.

The rule that the Commission proposed on swap execution facilities will create an inflexible model whereby all requests for quotes must be submitted to, at a minimum, five swap dealers. The more flexible approach being considered in Europe and also by the SEC would allow counterparties to submit a request for quote to a single dealer and still satisfy the trade execution requirement. This is another area where there is a potential for regulatory arbitrage.

In other areas such as capital and margin requirements for uncleared swaps, exemptions from mandatory clearing for inter-affiliate transactions and ownership limits on market infrastructure, we may not know the extent of regulatory divergence for some time, but our staff continues to work closely with our regulatory counterparts as rules develop.

I am also concerned about the uncertainty we are creating in the marketplace by not addressing the application of Dodd-Frank to foreign entities in foreign transactions. Section 722(d) of Dodd-Frank explicitly states that the Act does not apply to activities outside the United States unless those activities have a direct and significant direction with activities in, or effect on, commerce of the United States or contravene the rules that the Commission may promulgate to prevent evasion of the Dodd-Frank Act. The Commission has not given the public any formal guidance on what this section means in practice.

In the past, staff at the Commission has used its authority to rely on the assistance of foreign regulators for the supervision of entities located abroad, so long as the foreign jurisdiction is found to have a comparable regulatory structure in place. Unfortunately, we have not proposed a mechanism to do this with respect to any of the rules being put forth under Dodd-Frank. This has already created regulatory uncertainty for firms with global operations as they attempt to plan for the future.

Not only will our failure to establish clear rules in this area leave firms unable to determine what their compliance obligations may be, but it will most certainly drain critical Commission resources if we attempt to respond to these questions on a case by case basis. I am hopeful that this is one of the areas in which the CFTC and the SEC will each adopt a similar approach to prevent market participants from being subjected to multiple interpretations.

Finally, I believe that one of the most important components of this new regulatory landscape for swap transactions is to achieve global consistency and cooperation. I believe we must maintain clear sight of our global objectives of improving transparency, mitigating systemic risk, and protecting against market abuse in the derivatives markets as we address the challenges in front of us. Thank you for inviting me to testify today and I will answer any questions from the Members of the Subcommittee. Thank you.

[The prepared statement of Ms. Sommers follows:]

PREPARED STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Good morning Chairman Conaway, Ranking Member Boswell and Members of the Subcommittee. Thank you for inviting me to today's hearing on "Harmonizing Global Derivatives Reform: Impact on U.S. Competitiveness and Market Stability." I am Jill Sommers. I have worked in the derivatives industry for over fifteen years and have been a Commissioner at the Commodity Futures Trading Commission since August of 2007. The views I present today are my own and not those of the Commission.

Over the past 10 months, the CFTC has been moving at a rapid pace to promulgate swaps rules included in the Dodd-Frank Act. Staff has been working closely with their counterparts at the Securities and Exchange Commission (SEC) and other U.S. regulators, and has been consulting closely and sharing draft rulemaking documents with regulators in the European Union (EU), United Kingdom, Japan, Canada, and elsewhere. Notably, staff has been communicating daily with the European Commission to narrow differences on derivatives reform between our jurisdictions. This unprecedented level of cooperation has proven effective in aligning regulatory objectives and harmonizing most regulatory requirements.

However, I am concerned that (1) some important substantive differences between derivatives reform in the U.S. and other jurisdictions do exist, (2) other jurisdictions are not as far along in their reform process, which may harm the global competitiveness of U.S. businesses, and (3) our failure to clarify how our rules will apply internationally has created a great deal of uncertainty, both in the U.S. and abroad. I would like to briefly address each of these issues today.

Timing

At the G20 summit convened in Pittsburgh in September 2009, President Obama and other world leaders agreed that "standardized OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end of 2012, at the latest." Other jurisdictions are working to meet this end of 2012 deadline, but we are working to implement reform much sooner. I believe a material difference in the timing of rule implementation is likely to occur, which may shift business overseas as the cost of doing business in the U.S. increases and create other opportunities for regulatory arbitrage.

In Europe, legislation on clearing and reporting requirements for over-the-counter (OTC) derivatives, called the European Market Infrastructure Regulation, or EMIR, may not be finalized until the end of summer. After adopting legislation, EMIR directs authorities to draft technical standards by June 30, 2012. While the timing differences on these specific reforms between the U.S. and EU will depend in large part on how quickly we are able to finalize and implement rules at the Commission, there is an even greater disparity in timing between the U.S. and EU in implementing other reforms to the OTC derivatives market.

Rules on mandatory trade execution and other provisions that are parallel to provisions in Dodd-Frank are being considered as part of a review of the EU's 2007 Markets in Financial Instruments Directive, or MiFID. However, formal legislation has not been proposed and I am not certain that these reforms will be complete until 2012 at the earliest. In Asia, Japan has passed its legislation and plans to implement reform by the end of 2012. Other jurisdictions such as Singapore, Australia, Hong Kong, and Korea are also either providing or planning to provide clearing services.

At the CFTC, on the other hand, after 10 months, eight public roundtables, fourteen open Commission meetings, and more than 50 proposed rules, notices, or other requests seeking public comment, we have nearly completed the proposal stage of our rules and are moving forward with reviewing comments from the public in preparation for drafting and voting on final rules. In order to do so effectively, however, I believe we must work at a more deliberate pace, not simply so that our timing is aligned with other jurisdictions, but so that we can thoughtfully consider proposed rules and ensure we get it right.

Substantive Differences

Beyond timing, carefully tailoring these rules to address legitimate concerns from the public, while upholding our statutory obligations, is, I believe, a critical component of rule writing. However, I fear these concerns may be addressed differently across jurisdictions. For example, a provision in the EU's proposed legislation on clearing and reporting of OTC derivatives would explicitly exempt multilateral development banks such as the International Bank for Reconstruction and Development. Such organizations, whose statutory mission is to combat poverty and foster economic development, are not exempt under any of the Commission's proposed rules, and I believe this should be addressed. As another example, the EU is considering exempting pension funds from mandatory clearing of their swaps transactions, while Dodd-Frank does not contemplate any such exemption.

I am also deeply concerned that differences remain with respect to rules being considered at the Commission and in Europe for the mandatory execution of swaps on a trading platform. The rule the Commission proposed on swap execution facilities, or SEFs, will create an inflexible model whereby all requests for quote must be submitted to, at a minimum, five swap dealers. The more flexible approach being considered in Europe (and also by the SEC) would allow counterparties to submit a request for quote to a single dealer and still satisfy the trade execution requirement. This is another area where there is a potential for regulatory arbitrage.

In other areas, such as capital and margin requirements for uncleared swaps, exemptions from mandatory clearing for inter-affiliate transactions, and ownership limits on market infrastructure, we may not know the extent of regulatory divergence for some time, but staff continues to work closely with our international counterparts as rules develop.

Extraterritoriality

I am also concerned about the uncertainty we are creating in the marketplace by not addressing the application of Dodd-Frank to foreign entities and foreign transactions. Section 722(d) of Dodd-Frank explicitly states that the Act does 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 or contravene rules that the Commission may promulgate to prevent evasion of the Dodd-Frank Act. The Commission has not given the public any formal guidance on what this section means in practice. In the past, staff at the Commission has used its authority to rely on the assistance of foreign regulators for the supervision of entities located abroad so long as the foreign jurisdiction is found to have a comparable regulatory structure in place. Unfortunately, we have not proposed a mechanism to do this with respect to any of the rules being put forth under Dodd-Frank. This has already created regulatory uncertainty for firms with global operations as they attempt to plan for the future. Not only will our failure to establish clear rules in this area leave firms unable to determine what their compliance obligations may be, but it will most certainly drain critical Commission resources as we attempt to respond to questions on a case-by-case basis. I am hopeful that this is one of the areas in which the CFTC and the SEC will each adopt a similar approach to prevent market participants from being subjected to multiple interpretations.

I also wanted to briefly mention differences between the U.S. and Europe in our approach to position limits. The Commission has for years imposed position limits in the agriculture commodity markets, and has proposed a rule to impose position limits in the energy and metals markets. Regulators in the EU have historically not used position limits and, even under current proposals, may only mandate position limits in agricultural commodity markets. This is an area in which we need to ensure that our rules are harmonized to the maximum extent possible.

I believe one of the most important components of this new regulatory landscape for swap transactions is to achieve global consistency and cooperation. I believe we must maintain clear sight of our global objectives of improving transparency, mitigating systemic risk and protecting against market abuse in the derivatives markets as we address the challenges in front of us. Thank you. I am grateful for the opportunity to speak about these important issues and am happy to answer any questions.

The CHAIRMAN. Thanks, Ms. Sommers, we appreciate that. Mr. Chilton, your comments?

STATEMENT OF HON. BART CHILTON, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Mr. CHILTON. Thanks. Thanks, Mr. Chairman. Thanks for inviting me. Thank you, Mr. Boswell, Ranking Member Peterson, Members of the Committee. It is great to be with Commissioner Sommers, my colleague. She is the chair of our advisory committee on global markets and she does an excellent job. We owe her a debt of gratitude for the meetings she has put together.

Mr. Conaway, I actually agree with a lot of what you said at the beginning about making sure—and what my colleague said about being sure we do this in a deliberate way and that we are careful, and that we don't create these opportunities for regulatory arbitrage. But I guess where I diverge is that you know the law is the law. That is our mandate to deal with and I think it is a good law in that we had this economic fiasco and clearly the regulatory apparatus we have for the OTC land, this is the over-the-counter swaps. None of the companies that had to be bailed out went under because of business done on the regulatory exchanges.

The regulatory exchanges in the U.S. did very well, and I think we did a good job of regulating them. But the over-the-counter swaps were a credit. The dresit default swaps were created and led to the downfall of AIG and this hideous bailout we had. That is the regulation that we are trying to deal with. That is really the focus. I think we need to do it. The question is doing it in a deliberate way, as you said, Mr. Chairman, and making sure that we are cautious and we don't go too far and overreach. And we are in the process of the rulemaking right now.

I think if we do it the right way, it will actually not just make markets safer and sounder, but that it will be more efficient and effective. If you looked at markets, whether it is, hogs or corn, or metals or energy, you will see a lot of nearly unprecedented volatility recently. And we can address part of that through some of these rulemakings. But I think the added residual benefit if we do it correctly is that it will, in fact, make us more competitive, that people will want to use our markets more because we have legitimate sideboards on the regulatory—our regulatory regime. I don't know. Mr. Boswell left, but that movie, *Field of Dreams.* I don't know if anybody remembers it where Kevin Costner talks to the cornfield, and it says, "If you build it they will come." I sort of had that view about regulation and the Europeans, that if we went first that maybe they would come along, but I wasn't sure. And I think what is being demonstrated now is that they really also believe that it will give them a competitive advantage if they have the regulatory regime in place.

And so, actually by listening to my colleague's timing on a lot of this I think it is different than what we would have thought 2 years ago or a year and a half ago. We were talking about delays of 1½ or 2 years between the U.S. and the EU. But that chasm has been compressed now so that we are not looking at a year delay. We are looking at maybe 6 months and that is if we don't, for example, stagger our implementation. We are required to do things by certain dates under the law. We are not going to meet all our deadlines because we want to be deliberative.

But there is a provision in Dodd-Frank that says we can't implement it—a final rule—we can't require anybody to do anything in less than 60 days, but there is no end time. We could implement it in 2 years. I am not suggesting that, but it gives us the flexibility. If we think we are going down the wrong path and this Committee or any other Committee wants to call us up and tell us we are doing a bad job, it gives us the ability to delay that already. We have that authority currently. It is in the law and I think it is a good provision.

So as Commissioner Sommers said we are working really in an unprecedented fashion, not just with our colleagues on the SEC and other Federal agencies, but with our European counterparts. The Chairman has been over there many times. Some of us have been over there talking about these issues, and I think we are actually making significant progress on harmonizing. And while I am concerned about regulatory arbitrage to some extent—I think that we have to be, I think ultimately I am very optimistic about where we are headed.

You know in that movie, I don't know if maybe he is talking about something nobody remembers, but the banker constantly wants Kevin Costner to sell the farm. He says you got to sell it. You are going under. You got to sell it. You have Kevin Costner invest in a baseball diamond and finally at the end the banker says wait a minute. Where did all these ballplayers come from? Don't ever sell this farm.

And I know this isn't a dream. I know this isn't a movie—that we are talking about serious issues here but there is a little bit of a parallel in that if we invest in these regulations then they will have greater value. And I think the banks are beginning to see that. I think the traders are seeing that. It is just a matter of not going too far and seeking the right balance. And if we do that, we need the budget to do that as Ranking Member Boswell and Ranking Member Peterson talked about. We need the budget to do that. You know the thing that passed yesterday in Appropriations Subcommittee is a 45 percent cut from the Administration's proposal and a 15 percent cut from the current fiscal year budget. So, we won't be able to do the job that we have been asked to do if we don't have the resources.

But ultimately, I believe, Mr. Chairman, that if we do this the right way it will make us more competitive and that this will be good not just for market participants, not just for the folks that are going to testify later and in this room, but it will actually be good for consumers, and it will be good for the economic engine of our democracy. Thanks very much.

[The prepared statement of Mr. Chilton follows:]

PREPARED STATEMENT OF HON. BART CHILTON, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Good morning, Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, and thank you for inviting me to today's hearing on global derivatives regulation. I am pleased to testify alongside my colleague, Commissioner Jill Sommers, who does an outstanding job as the Chair of our Global Markets Advisory Committee (GMAC).

I believe the financial regulatory reforms that we are currently working upon in the U.S., and specifically at our agency, will make the U.S. futures industry safer, sounder, more efficient and effective, and more competitive than ever before. I also believe that the European Union has the same view with regard to the need for financial regulatory reform, and the benefits thereof. The U.S. and the European Union are the predominate swaps markets, and reform in both of these markets will provide the basis for other jurisdictions to undertake similar measures. I am hopeful that our brethren Asian regulators also have such a view.

I would note with great concern consideration by the House Appropriations subcommittee of language that would essentially cut our budget. To my mind, this is penny-wise and pound-foolish. We went to the brink of economic disaster, Congress gave us the directives in Dodd-Frank to ensure that doesn't happen again, and now there are those who would keep us from having the budget to do the job.

This morning I will provide comments on the status of the Commodity Futures Trading Commission's (CFTC's) efforts in the area of international harmonization on derivatives reform and implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I will be meeting with regulators in several European Union countries in June, and so my remarks are made in light of those upcoming discussions.

We have been coordinating—in an unprecedented manner—with our European and Asian counterparts on all major issues relating to the implementation of over-the-counter (OTC) oversight regulation. Of course, there are differences on some provisions of our respective laws, but the level of overall harmonization is substantial. In addition, it's fortuitous that many jurisdictions are developing regulations contemporaneously. This allows us to craft corresponding, standardized, conforming, or complementary rules as appropriate.

In addition to frequent, ongoing, and productive staff phone contact with regulators around the world, we also maintain—as much as possible with our budget constraints—face-to-face contact with foreign regulators. Our Chairman made two visits to Brussels over the past year to speak to high-level European politicians about the legislation, and our director of international affairs also meets regularly with the European Commission's financial attaché here in Washington to discuss salient issues. We also have video conference with European Commission staff and the other U.S. financial regulators on OTC regulatory reform. In addition, we participate in numerous International Organization of Securities Commissions (IOSCO) and Financial Stability Board (FSB) committees, which are instrumental in providing fora to discuss and develop policy and guidance.

Generally, in our international discussions, we are guided by the 2009 Pittsburgh G20 Communiqué, which set forth four key directives which all G20 countries must implement by the end of 2012. Those are, specifically:

- *Clearing* of all standardized OTC derivatives;
- *Trading* on an exchange or electronic trading platform, "where appropriate";
- *Reporting* of all OTC derivatives to a regulator or trade repository; and
- *Higher Capital Requirements* on uncleared derivatives.

These four elements provide a useful benchmark that entities such as IOSCO and FSB can use in their assessment of progress on OTC reform. Most importantly, these guidelines are consonant with the Congressional directives provided in the Dodd-Frank Act.

Dodd-Frank is our primary compass in this area, and Section 752(a) of the Act expressly provides for international coordination on regulatory matters. In that vein, we are adjured specifically to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards" as to OTC transaction regulation.

As we move forward in this area, one of the thorniest issues we have to deal with is the topic of "extraterritoriality." Section 722(d) of Dodd-Frank provides that the Act won't apply to activities outside the U.S. unless they have a "direct and significant connection with activities in, or effect on, commerce" in the U.S., or contravene Commission regulations needed to prevent evasion of the futures laws. This is an issue that has been the subject of much legal debate, but I think that we need to cut through that morass to provide some certainty to market participants who are concerned about what laws are going to apply to them. In that respect, while we don't yet have all the answers, we are working toward a consistent method to discuss and develop a satisfactory resolution of the issue, and provide legal certainty for markets and participants. Just as we have with all of our other Dodd-Frank initiatives, we welcome the input of market users in addition to that of our fellow regulators, here and abroad.

As to the timing of initiatives, while the European legislation that is set forth in the European Markets Infrastructure Report (EMIR) and in the European securities laws (MiFID) are likely to be adopted later this year (and thereby putting Europe somewhat behind the U.S. timeframe), in practice, this may have little substantive impact, as Chairman Gensler has indicated that we will be pursuing a phased implementation in the U.S. In each jurisdiction, the key goal is to meet the end-2012 deadline set by the G20.

In closing I'd like to briefly mention two issues that are particularly important to me: speculative position limits and high frequency traders (HFTs). I appreciated the opportunity to testify before this Subcommittee last December on speculative position limits. Dodd-Frank provides that, in establishing position limits for exempt and agricultural commodity futures and options traded on or subject to the rules of a designated contract market, the Commission "shall strive to ensure" that trading on foreign boards of trade (FBOTs) in the same commodity will be subject to comparable limits and that any Commission limits will not cause price discovery in the commodity to shift to trading on FBOTs. We are considering how we can engage foreign regulators to ensure parity in regulatory controls over significant position holders. In the E.C.'s MiFID review, it is considering giving all national regulators the power to impose position limits. I have said numerous times that we in the U.S. can and should do better in this area, that there are things we can do now (such as spot month limits in swaps and on the regulated exchanges, based on a percentage of deliverable supply). I hope that we, both in the U.S. and internationally, can move forward expeditiously in these efforts to protect markets and consumers from excessive speculation.

As to HFTs, while I recognize the value that these participants can bring to the market in terms of adding liquidity and tightening spreads, I have concerns about some possible negative effects that this relatively new type of activity may have on traditional market uses. I have heard from commercial entities, and indeed from some HFTs themselves, that this is an area that deserves some heightened scrutiny from regulators, to ensure that all market participants get a fair shake and a level playing field. I look forward to working with my colleagues, here and abroad, to ensure that these types of market innovations do not result in anticompetitive effects for any markets or participants.

Thank you again for the opportunity to testify. I'd be pleased to answer any questions.

The CHAIRMAN. Thanks Mr. Chilton. I appreciate that. Mr. Peterson, just by way of clarification, the restriction on the $25,000 that was in yesterday's mark-up was in the 2009 Appropriations bill—exact same language when you were chair.

Mr. PETERSON. No—will the Chairman yield?

The CHAIRMAN. Yes.

Mr. PETERSON. No, I am aware of that, but in 2009 we didn't have this issue in front of us and we weren't obviously having a hearing worrying about harmonization, so——

The CHAIRMAN. Well, it—

Mr. PETERSON.—it would appear to me that the right thing to do would be to take that restriction out of it.

The CHAIRMAN. Right. Yes, the implication I had from you that we stuck it in there kind of out of left field in whole cloth and it wasn't—real provisions, okay.

Mr. PETERSON. No, no, I just think it is ironic that we are sitting here concerned about making sure that we harmonize and yet we are putting restriction on them. And as Mr. Chilton just said, you know we are also cutting their budget significantly and this is going to—I think it is going to cause a bigger problem than some of those other——

The CHAIRMAN. Well, I don't disagree that the provision probably shouldn't be in there, but I just also want to make sure the record reflects——

Mr. PETERSON. Well, well——

The CHAIRMAN.—that was carried over. And probably——

Mr. PETERSON.—maybe we can work together to get it out——

The CHAIRMAN. Exactly.

Mr. PETERSON.—when the bill comes to the floor.

The CHAIRMAN. There will be a period of time when the regulations are different no matter what happens under the—you can't paint a scenario in which everybody pulls the trigger on the exact set date, so there will be a natural period for arbitrage that we will be able to observe. Maybe because it doesn't look to be permanent there won't be a lot of movement between markets as a result of forum shopping or regulatory scheme shopping, however you want to phrase that. But Ms. Sommers, first and then Mr. Chilton, how are you going to address clear meaningful differences between the EU proposals and/or Asian proposals as you get the final rules in place once they get theirs in place and you see perhaps a better scheme. How—what kind of flexibility does the Commission have to adjust on the fly for the betterment of all the good things that Mr. Chilton said at the closing of his comments?

Ms. SOMMERS. Thank you, Mr. Conaway. I think that you made a very good point in your question by saying that we probably won't all pull the trigger on the same day. The important part is that we make sure that the rules are in—as consistent as possible across jurisdictions no matter what date they are put into effect. So what we are doing right now is trying to make sure that any of the inconsistencies that do exist, that we know exist, we are working to resolve those with our counterparts. The hard part for us will be if we have already finalized a rule this year with regard to trading requirements, reporting requirements—when those are not even going to be considered in Europe. We wouldn't see what the legislative text would look like until this time next year.

The CHAIRMAN. Well, what are the mechanics that you have available to do that? Do you have to go through the full new rule proposal altogether if you?

Ms. SOMMERS. Right. If we want——

The CHAIRMAN. Let us assume that Europe came up with a scheme that we like better. We would have to repropose——

Ms. SOMMERS. Right.

The CHAIRMAN. And then while that is going on we would have an industry that is out there putting in systems and building a scheme to comply with our rule, and yet we are headed in a different direction. So you would have to go through this whole rule making process again?

Ms. SOMMERS. We would have the ability to re-propose a rule if we wanted to change something that we had put in place.

The CHAIRMAN. Mr. Chilton, any comments about how flexible you guys——

Mr. CHILTON. Just briefly, Mr. Conaway, you know that we are in the middle of a process. This is sort of like, you don't want to call an end to it, but we do have *plenary authority,* in general, in the Act that we could go in and re-propose a rule. We also have a provision in there that talks about comparable and comprehensive regulations. So we can sort of say well, there is another agency in Europe or wherever, they do a good job. But we can also say we are not so sure about that. So we have authority where we could go in and be creative if we see a problem that would create issues for U.S. businesses or for U.S. consumers. But I agree. We need to be deliberate on this. We need to make sure we are working closely with them.

The CHAIRMAN. Ms. Sommers, is there—do you have a counterpart in the SEC of an advisory committee that looks at harmonization for not only the SEC share of Dodd-Frank but yours and the international link? Do you have a—is there a round table or something that you guys work with?

Ms. SOMMERS. To my knowledge the SEC doesn't have advisory committees, but SEC Commissioner Kathy Casey is very involved in international issues. She and I both participate in IOSCO meetings. Ms. Casey participates in the Financial Stability Board, so they are also very actively coordinating with international counterparts.

The CHAIRMAN. Is there a rational conversation between you two——

Ms. SOMMERS. Absolutely.

The CHAIRMAN.—at reference to making sure, because we have some instances already just between our two regulators in which you have the industry jammed up. Okay. Then I yield back. The Members will be recognized for questions on seniority of when the gavel went down, for those that were present. So with that we will go to Mr. Boswell for 5 minutes.

Mr. BOSWELL. Well, thank you. These are challenging times. Don't make any mistake about it. I catch myself saying that history is being written. We just don't know what it is going to say. It is kind of up to you and us to make it the best we can and it probably won't be perfect, but we have to do the best we possibly can. I was called away so I didn't follow everything that you said, Mr. Chairman, but I don't want to get—if I get redundant just give me an elbow and I will move to another—no, I am serious. I don't want to do that because I read the report. But, did you discuss somewhat more about the cooperation, the unprecedented level of cooperation among foreign regulators? Did you discuss that? Did you make any further comment on that?

Ms. SOMMERS. Yes, sir. In my testimony I did discuss it.

Mr. BOSWELL. Yes, okay. We will pass on that for a minute. Regarding your testimony, Commissioner Sommers, positional limits—is it your view that if the Europeans decide to let speculators have free reign by imposing no position limits that we should match them in order to, "ensure our rules harmonize to the maximum extent possible?"

Ms. SOMMERS. No, sir. I—our markets and specifically with addressing the enumerated agricultural markets, we do have position limits. Europe does not have those limits on their agricultural markets, so I think that the system that we have right now works very well for us and works in our agricultural markets. We also have accountability levels in our energy complex which is consistent with what they have right now for those products that trade in the UK. I am suggesting that I think we try to harmonize what we may do in the future with them as well.

Mr. BOSWELL. Okay. Mr. Chilton, you have any comment on that point?

Mr. CHILTON. Just briefly, there are spot month limits in the agriculture commodities. The law requires that we have not only spot month limits in just the agriculture, but also in the metals complex and the energy complex, so we are expanding. It also requires that we have deferred month limits, so that would be other months and then an aggregate limit and this is both for the OTC area and for the regulated exchanges. So it is true that we have had position limits in ag, and quite frankly, I think it is sort of a testament to how well position limits can work, that we have had them for so long, and that by in large there haven't been too many problems. So, I am hopeful as I have said before this Subcommittee and many times that we put limits in place right now. I think that we wouldn't see such volatility in some prices and that it wouldn't actually impact that many traders, the proposal that we have had. We said that you can't have more than ten percent of a market. Then we have a little multiplier on there over—in markets with over 25,000 contracts you can have 2.5 percent of it. So, I mean we are talking about very large positions. You know if it were my decision I would probably be a little bit more restrictive, but I think our proposal, Mr. Chairman, errs on the high side to allow for us to put some legitimate limits, only the largest of the large would be under this. I think that would help markets, but ultimately we may have to recalibrate, reassess where we are on the limits. Thank you for the question.

Mr. BOSWELL. Well, I will address this question to you first then. Your testimony cites the Dodd-Frank requirement for the Commission that these limits do not cause price discovery in the commodity to shift trading to foreign boards of trade. Given your interest and speculative position limits, how is the Commission working to balance the needs of setting appropriate limits for speculators without encouraging mass migration to foreign markets?

Mr. CHILTON. That is a good question. I will try to be brief, Mr. Boswell. We have an agreement already that we reached with the IntercontinentalExchange in London where they have a look-a-like contract to our West Texas Intermediate Crude and they actually—working with the FSA, the regulator in the UK, they actually give us data on a daily basis. And they have said and the IntercontinentalExchange has said that they would comply with limits that we would put in place. You know again, I think you err on the high side on limits at first because you don't want to have these market disruptions. You don't want to have migration and then you see whether or not you need to recalibrate at some point. Is our proposal that we call 10 and 2.5, that I explained, is that the magic number? Is that the same for—should it be the same for silver as it is for crude oil? I don't think so, but right now we should just err on the high side, get them in place, have folks get used to them, and then if we need to recalibrate, then we could recalibrate up at some point if we think we need to. Not many people have given us a whole lot of heartache on the limits being too restrictive so far. A few, but not many.

Mr. BOSWELL. Thank you.

The CHAIRMAN. Thanks, Mr. Boswell. We will deviate just a minor bit to recognize the Chairman of the full Committee, Frank D. Lucas.

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

Mr. LUCAS. Thank you, Mr. Chairman, and I appreciate the courtesy. Commissioner Sommers, I want to congratulate and thank you for addressing the very real concern about legal certainty at the Commission's last public meeting. And I share this concern as do a growing number of market participants. I sense that if it weren't for the need to respond to the Commission's crushing request for comments on some 60 proposed rules, the legal certainty issues would be the primary concern for all currently engaged in trading OTC swaps. As you know, Commissioner, the CFMA protected the OTC swap markets from being regulated like futures contracts by exempting them from the futures contracts regulatory scheme. Dodd-Frank eliminates that exemption or legal certainty. Swap contracts have been relied on for nearly a century opting for a robust regulatory scheme of the OTC swap market. The very real problem that we have now is is that the legal certainty is eliminated on July 16 of this year, but the new regulatory regime created by Dodd-Frank won't be implemented by then. And by some estimates won't be implemented perhaps for a year or 2. Just this morning I received a copy from the Electric Trade Associations petition for reconsideration of an exemptive relief. I would like to submit, Mr. Chairman, this petition submitted by the National Rural Electric Cooperatives Association and four other trade associations for the record.

The CHAIRMAN. Without objection.

[The document referred to is located on p. 109.]

Mr. LUCAS. Thank you. With Chairman Gensler's continued optimism concerning the implementation schedule, I can understand why the Commission rejected the Association's petition back in December. But now 5 months later and less than 2 months away from the implementation date, it is crystal clear that the end-users will be looking for and need similar relief. Can you tell this Committee if the Commission will look differently upon the Associations petition to have its swap activity grandfathered and remain legally certain under the Commodity Exchange Act? Can you—would you suggest ways that we can aid and broaden your review of these applications?

Ms. SOMMERS. Thank you for the question, Mr. Chairman. I think that the Dodd-Frank statute does provide the CFTC with the authority to grant grandfather relief to the sections 2(h)(1) and 2(h)(3) markets. We did address that by asking for entities to submit petitions to us last fall. We denied granting this grandfather relief because as you said we were hopeful that the new framework would be in place by then. I do think that we have the authority to grant these entities relief to let them continue to rely on the Sections 2(h) that were put in the Act by CFMA, and we could do that by Commission order. And I would hope that we would be able to do that for the section 2(h)(1) and section 2(h)(3) markets.

What we are not able to do because the statute does not give the CFTC the authority is to address the repeal of other provisions like sections 2(d) and 2(g). Market participants that rely on the relief under sections 2(d) and 2(g) would not be able to have the legal certainty given to them under the grandfather relief.

Mr. LUCAS. It would appear then that the—in this case the Electric Trade Associations have a real point and a real bone of contention and that—I do not pretend to be an attorney, Commissioner, but I can see where the certainty ends on July 16. Up until the point either a relief is provided in part of the issue or the final rule is put into place, I can see if where I thought I were legal counsel to these groups, I would be spastic about making any new decisions or engaging in any contracts. Is that an unreasonable observation on my part?

Ms. SOMMERS. No, sir. I do believe that the Commission needs to take some action in this and within these issues.

Mr. LUCAS. Thank you, Commissioner. I yield back the balance of my time, Mr. Chairman.

The CHAIRMAN. Thanks, Mr. Lucas. The chair now recognizes the Ranking Member of the full Committee for 5 minutes.

Mr. PETERSON. Thank you, Mr. Chairman. Ms. Sommers, you have been involved in this international stuff. Have you heard about these rumors that I have, about people going to the regulators and trying to come up with lighter rules? Have you heard any of that?

Ms. SOMMERS. I have not heard specifically from foreign regulators that those comments have been made to them, but I can assure you that they are—those concerns are expressed to us quite frequently with regard to any sort of inconsistency within the rules and making it easier for foreign competitors to do business than it is for U.S. businesses. They are stressing to us that companies here are concerned about any inconsistencies. So as we work forward implementing all of these rules, I think all of us have to keep that in mind that we want to be as consistent as possible with our international counterparts and that is what we are trying to do.

Mr. PETERSON. Can either one of you tell me the practical impact of this—if this appropriations bill that went through yesterday actually becomes law and you—it is a reduction of about $30 million from what you have now. Do you know what impact that is going to have? Or if you don't is there some way to have somebody from the Commission give us information about what would actually happen if the cuts took place. What wouldn't you do that you would normally do and so forth? And then also on this $25,000 deal if that is going to limit your ability to work with the foreign regulators, should we get rid of that limitation? I don't know if you have answers to that today, but——

Ms. SOMMERS. I do not have specific information about the $25,000. I would guess that that does not limit our ability to travel to——

Mr. PETERSON. No, I don't think it does, but it apparently limits your ability to host people here. That is not very much money, you know. And I think the European regulators were just here. I guess this has been in the law. I don't know, so I don't know how it works exactly. But I guess if somebody down there that deals with this can get me that information. That would be helpful.

Ms. SOMMERS. We can absolutely get you more specific information. Just with regard to the first part of your question, as you know, we just received our appropriation for 2011 a few weeks ago and received approximately a $35 million increase in our budget which was very helpful because a significant portion of that money went towards technology. And that is one of the places that we are in most dire need. The number that was marked up yesterday would take us back to approximately the level we were at in Fiscal Year 2010.

Mr. PETERSON. So that probably would impact the technology more than anything then?

Ms. SOMMERS. I would guess that that is true.

Mr. PETERSON. In the last one we had—I had been told and I guess I haven't actually seen this in writing that a couple—3 weeks ago Goldman Sachs said that they thought that all this uncertainty, all this passive money in the oil market had raised the price of oil $27 a barrel and then somebody else, some other group said it was $20 a barrel. Is that in fact the case?

Mr. CHILTON. Well, I am not an economist.

Mr. PETERSON. No, no, but I mean were those statements made?

Mr. CHILTON. Those are statements—you accurately reflect statements that other people made. And a lot of people want to make these arguments and they want to have an actual number and I have been very reluctant to ever give them. But yes, Goldman made that statement and so have others. Just let me say, Mr. Chairman, briefly on the budget. It would be crippling to our budget—we would not be able to enforce the regulations that Congress asked us to do so under the proposed budget that was approved yesterday.

Mr. PETERSON. But——

Mr. CHILTON. We could——

Mr. PETERSON.—you could write the rules?

Mr. CHILTON. We could write the rules but we would be a hollow shell. We wouldn't be able to actually enforce them. And you know, Members, we are going from a $5 trillion annualized trading in the regulated exchanges to hundreds of trillions of dollars. And Commissioner Sommers is absolutely right on the technology. There is something that I have talked about a lot recently called high frequency traders. And I call them cheetah traders as in the fastest land mammal because they are so fast, fast, fast. I think they are having an impact on markets, but we can't keep up with these guys. We can't keep up with the cheetahs. And when I say that I am not like with a Boston accent, like a card cheetah. But we can't keep up with these guys because we don't have the technology, so we need the budget.

Mr. PETERSON. All right, thank you Mr. Chairman.

The CHAIRMAN. Yes, sir. The gentleman yields back. Mr. Neugebauer for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I thank the panel. I want to go back to a little bit about this harmonization process and particularly around the swap activities occurring outside the United States. Is it my understanding that both the CFTC and the SEC have yet to address the territorial scope of their proposals. But however, in April, the prudential regulators proposed a rule for the application of margin requirements as required by Title VII for major swap participants and swap dealers. Under this, prudential regulators proposed margin requirements would apply to all transactions of U.S. financial institutions whether they are U.S. or non-

U.S. customers. And so the question that I have is that if we haven't worked out the territorial issues, to me this is going to put some of our U.S. companies in somewhat of a disadvantage here if they are having to impose those on their non-U.S. customers. So I think these are the kinds of things that many of us are concerned about in this harmonization process. Ms. Sommers, do you want to address that?

Ms. SOMMERS. Thank you for the question, Congressman Neugebauer. I think that the proposal that was put forth by the prudential regulators is with regard to the capital and margin for banks or bank holding companies that they regulate. So it is for swap dealers or major swap participants that are under the regulation of the Fed or prudential bank regulators. There is no question that they address, you know the issue of extraterritoriality within that provision by saying that if capital and margin would apply to all activities of U.S. businesses and that potentially could put U.S. businesses at a competitive disadvantage.

What we are looking towards is harmonizing capital and margin with our regulatory counterparts in Europe. So if, for instance, Europe imposes the same type of capital and margin scheme in Europe on their regulatees, then there would not be a discrepancy between what foreign banks would have to post *versus* what U.S. banks would have to post. We just don't know. At this point there is some uncertainty.

Mr. NEUGEBAUER. Well, and here is I think one of the things that could concern me is that if we are out in front of everybody and then we assume, as you articulated that you feel like you are in a cooperative mode with these regulators; but ultimately the people you are negotiating with probably aren't the people that are going to vote on whether to adopt those are not.

Mr. SOMMERS. That is right.

Mr. NEUGEBAUER. And so what would be—what does the world look like in a year or 2 when the parliament or the governments in the Asian markets decide to adopt different and maybe less restrictive regulations, then what is our recourse at that particular point in time?

Ms. SOMMERS. I am not sure, but I think as Mr. Conaway suggested, we would have to rethink our regulations in my opinion.

Mr. NEUGEBAUER. So is there, Mr. Chilton, did you want to reflect this?

Mr. CHILTON. I will try to be brief.

Mr. NEUGEBAUER. Yes.

Mr. CHILTON. You know, the law says that we have this provision where we can defer if something is comparable and comprehensive like I talked about earlier, but we also have this provision that people talk about section 722(d) in the Act, which says that if the activity has a significant and direct impact on U.S. commerce. So we could at some later point, Congressman, say, "You know what? Now that we have seen what the EU has done maybe we want to reassess that issue of significant and direct impact." I think we have some flexibility.

Mr. NEUGEBAUER. Well, I just want to go to an agricultural question and it is really for my edification. So the other—obviously agriculture in U.S. uses commodities and hedging opportunities extensively. Do we see that same kind of activity in other countries? Are other countries utilizing the hedging strategies as well?

Mr. CHILTON. Yes, and a lot of them, Congressman, use our markets for those strategies. Mr. Boswell was talking about cotton early. Some of the volatility we have seen in some of the markets occurs actually when our markets aren't open during the trading day, but during the overnight trading hours when some of these electronic firms and maybe some of the cheetah traders are involved in the market. So, they use our market. They do use them for agriculture hedging, sir.

Mr. NEUGEBAUER. Yes, this will follow-up, is my understanding that the transactional fees in some of those markets are less than the transactional costs in our markets. So is cost a part of this harmonization piece?

Mr. CHILTON. Well, those are generally set by the exchanges, sir, so you know they all have their own business propositions, so I don't know about the exact transaction cost in exchanges outside of the U.S. I am sorry.

Mr. NEUGEBAUER. Yes, I think—and I know that my time—I think one of the things I was talking about was not setting the price, but also making sure that the parameters are such that the pricing should be more market driven.

The CHAIRMAN. The gentleman yields back. Mr. Kissell, 5 minutes.

Mr. KISSELL. Thank you, Mr. Chairman. Thank you for this opportunity to have the hearing today and try to examine the implementation of this most important legislation. And thank you, Commissioners, for being here today. My first question is one of curiosity. I happened to read, and it is probably 3 weeks ago and it was in a newspaper that indicated that there were concerns in Europe that certain banks there were trying to dominate and manipulate the derivatives market and they were being investigated. I was just wondering if you have knowledge of that. If so, how accurate of a summary was that and what implications might it have towards what is going on here?

Mr. CHILTON. I will give sort of a bureaucratic answer to you, Congressman Kissell. You know we can't comment on any investigations that we have, *et cetera*. I read the news story that you did, but, unless we were in Executive Session, we couldn't discuss it.

Mr. KISSELL. Well, that was not the answer I was expecting, but I understand that answer. It would seem to me that it would indicate there are certain issues that are taking place in the markets over there that we are trying to avoid long term, and some of the problems that we have had here in the markets. So, I thought it was kind of interesting. And so at some point in time if we could elaborate there it would be interesting to know how that might affect the discussions here.

Mr. CHILTON. Congressman, I just want to be clear. I am not suggesting anything either way. I am just saying that those sorts of questions about investigations would be done in an Executive Session. So I am not saying yes, no—I am not saying anything.

Mr. KISSELL. Understood completely. Understood completely. As we talk about the give and take of trying to implement regulations and Commissioner Sommers, you said we are not going to pull the trigger on the same date. And I think that goes without saying. As we have gone back and forth in looking at what we are doing *versus* what we expect some of the foreign markets to do, are there any exceptionally daunting challenges, things where we see that this could be bad? Anything that we know we have to overcome that just stands out above others in terms of trying to even this out as much as possible?

Ms. SOMMERS. Yes, sir, I do think that there are some inconsistencies that do exist currently. Of course, Europe has not passed a final version of their legislation yet, so anything could happen from now until then. Some of the issues that I point out in my testimony with regard to pension funds, they are exempting pension funds from the clearing requirement in Europe, and that is a significant discrepancy because we do not have the authority to do that under Dodd-Frank.

There may be differences in how they consider end-users in Europe. There may be differences in how they will allow trading on swap execution facilities. The current CFTC proposal requires a request for quote to go out to a minimum of five dealers. And Europe may not do that. If they have single dealer platforms, that will be a significant discrepancy. So those are issues that we are watching very closely.

Mr. KISSELL. And Commissioner Chilton, you indicated you know that we do have some flexibility in implementation of this as we see these things start to pan out as more definition is given. Are you comfortable, and I guess a question for both of you, comfortable that we have the structure to implement what we need to do, plus have the ability to adjust as we need to and still keep that structure?

Mr. CHILTON. We do not have the structure in place to deal with the regulation that Congress has asked us to undertake. We can't do it without the budget—particularly talking about the technology point that, Commissioner Sommers, I think you and I both agree on. But we don't have the staff. I mean, we have been looking at markets with $5 trillion annually. These markets are growing to be hundreds of trillions of dollars. We need to set up new divisions to deal with swaps. We need experts. We need economists. We don't have the ability to do it now, and the budget that is proposed would cripple us at this point. We could continue to do what we are doing right now, sort of the *status quo.* I don't think that is good enough. I think consumers demand more and I think given the realities of the economy in the last several years they deserve it.

Mr. KISSELL. Commissioner Sommers, any thoughts?

Ms. SOMMERS. I agree with Mr. Chilton that we no doubt need the resources to be able to implement all of the additional authority that we received under Dodd-Frank. I also think that, as we look through the authority we were given, we were not given exemptive authority, broad exemptive authority like we have had in the past. So if we look towards either foreign entities or domestic entities that we would like to exempt from the regulation, we don't have that authority to make those decisions within the Commission. But otherwise, I do think that we have some discretion and flexibility in what we propose.

Mr. KISSELL. Okay. Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman. Mr. Austin Scott, from Georgia, for 5 minutes. Mr. Scott?

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman, and I think we all agree that we are in a global financial market and certainly transactions can occur in the U.S. or outside of the U.S. and that is I think where our concerns are. But just to get a feel, and I know that there are a lot of people watching us, Commissioner would you—the total value of the outstanding contracts today for the OTC, what approximately is that?

Ms. SOMMERS. I don't have a current number for that. I think that the numbers that are usually thrown about are $300, $400, $500 trillion. Somebody on the next panel may have a much better idea of that.

Mr. CHILTON. She is right that the numbers are thrown around. *Bloomberg* said the other day $601. I thought it was $615 trillion. Last year it was $585. I don't know and that is the point.

Mr. AUSTIN SCOTT of Georgia. Yes, sir.

Mr. CHILTON. We don't know what is going on and that is why I believe we are given the authority to figure it out, because it had a direct impact on our nation's economy.

Mr. AUSTIN SCOTT of Georgia. Yes, sir. It is my understanding that it is somewhere north of $600 trillion and that even in the market value that would be over $20 trillion which is a huge number and which far exceeds even the value of the S&P 500.

Mr. CHILTON. Now, we wouldn't get all that, Congressman, because the SEC is going to do some of those which is a significant share.

Mr. AUSTIN SCOTT of Georgia. Yes, sir. But what I am getting at and it somewhat gets back to your question, Commissioner. I mean do we know—I guess what would help me and what I would ask if you would have somebody on your staff put it together. It is kind of the last 10 years, the increases on an annual basis of the value of the outstanding contracts as best we can estimate them, the gross market value of those contracts, the number of transaction annually. Do we have any idea how many transactions we have annually?

Ms. SOMMERS. BIS does publish some numbers on the over-the-counter market and we can get you those.

Mr. AUSTIN SCOTT of Georgia. And then the percentage of it that is debt related, has that changed? I mean, most of the time we see that ⅔ of it is debt related or over the course of time has that changed?

Ms. SOMMERS. I don't know the answer to that.

Mr. AUSTIN SCOTT of Georgia. And I think that gets back to one of the concerns that we have is that there are so many questions, and there are so many paths that we can go down. The European Union, my understanding is they have their list of exemptions. If it is easier for someone to trade overseas, they are probably going to trade overseas, but they also—the capital requirement that they set I mean, approximately $14 million U.S. dollars. Is that correct—for a clearinghouse? Is that—that is what was reported in *Bloomberg* or *Forbes* or one of the articles that I read—$14 million?

Ms. SOMMERS. Is this a capital requirement, I am sorry, on——

Mr. AUSTIN SCOTT of Georgia. Yes, sir. Yes, ma'am. I am sorry.

Ms. SOMMERS.—who?

Mr. AUSTIN SCOTT of Georgia. The capital requirement to be a clearinghouse. Was it $14 million?

Ms. SOMMERS. Their rules have not been finalized yet so I—this may be something that is in their current proposal. They did approve something within committee yesterday.

Mr. AUSTIN SCOTT of Georgia. Yes, ma'am. What do you expect the capital requirement to be? Just approximately what would you think would be an appropriate capital requirement?

Ms. SOMMERS. For entities that want to be clearing members of——

Mr. AUSTIN SCOTT of Georgia. Yes, ma'am.

Ms. SOMMERS.—of a clearing house? The open access provisions that we proposed in our proposal last fall, I believe we are at $50 million. Is that right, $50 million for an entity before they could be a clearing member of a clearinghouse.

Mr. AUSTIN SCOTT of Georgia. I personally feel that $14.1 million is a pretty small bank and even in South Georgia. I have some other questions, Mr. Chairman, but I will yield back to you. But I would appreciate it if you could have some staff—just so that we can help explain to the general public why it is necessary to do something at this stage.

The CHAIRMAN. If the gentlemen would yield? Could you modify that just a bit to add to that the number of contracts? I do think there is a—the number of contracts *versus* notional value may not track the growth and notional value may not track the number of contracts themselves. And the real issue is the number of contracts and players playing with those contracts. The notional value is important, but if we could add the number of contracts along that track as well. The gentleman yields back. Mr. Welch for 5 minutes.

Mr. WELCH. Thank you very much. One of the frustrations in the chair I sit in is this: On the one hand, the futures markets do play a very important role and historically have provided significant benefit to our farmers and to our consumers. But there is, I think beyond dispute, evidence that the financial markets have been inverted so that instead of them providing that price setting function they provide a speculator opportunity. And on the one hand speculators are an important part of the market to provide liquidity, but on the other hand if it gets out of balance, then the consumer ends up getting smashed. And I just want to—and so I get frustrated about that because we have to protect our consumers.

And then when we get into the rule-making question, I hear the concerns about the implementation of the regulations and the go slow approach. The focus then becomes about protecting the financial players in the futures market and that oftentimes, as I see it, comes at the expense of protecting the consumers. So there has got to be, and mind you Mr. Chairman, a bit of a balance here. And Ms. Sommers, I guess I want to ask you what your philosophy is. Do you see that the level of speculation that has injected itself into the futures market in fact is threatening the smooth functioning of that toward achieving its other goal of providing some protection to our consumers, our end-users, our commodity producers?

Ms. SOMMERS. Congressman, thank you for the question. I think that, it is part of our mission at the CFTC to make sure that our markets are free from abuse and manipulation and that is what we do every day. Looking at our markets, is making sure that we do not see manipulative activity or abuse in those markets.

Mr. WELCH. I am trying to understand this a little bit more. It is not necessarily manipulation. If the rules allow this enormous infusion of cash, people can legally do that. But their purpose and their use of that is different than some farmer in Illinois. And bottom line, who are we working for? Are we working for the farmer in Illinois, or the hedge fund in New York? They are both doing legal activities, but one comes at the expense of the other. So how do you see it, your responsibility as a Commissioner—I will ask Mr. Chilton this, too. When it comes to balancing those concerns: that farmer, who is trying to get stability in his price and that hedge fund guy who is trying to make a slight margin on a legal activity?

Ms. SOMMERS. I think that that is what our economists are there to do, to review the market activity every day to make sure that we don't see some sort of imbalance.

Mr. WELCH. Well, did you see that Mr. Peterson cited that Goldman study that said $27 in the price of a barrel of oil which is in the range of $100 now is due to a speculation premium? Do you agree with that? Do you have any reason to dispute that?

Ms. SOMMERS. It is just not something that our economists have put together. That is—it is not even——

Mr. WELCH. Well, why wouldn't that be of concern to you? I mean, if the average person going to the pump is paying 25 percent higher gas prices, $4 instead of $3, why is that not a concern of ours?

Ms. SOMMERS. Sir, I am not suggesting I wouldn't be concerned about that. It is something that our economists look at constantly and when there are issues, they bring them to our attention and we focus on those.

Mr. WELCH. Mr. Chilton?

Mr. CHILTON. I agree with your concerns, Congressman, and you know I talk about it a lot. But let me go right to this with regard to producers, ag producers. And I have heard this from a lot of folks. I do think speculators are having an impact. I don't think they are driving prices, but I think they keep them beyond what they should be. So I do think there is a speculative premium there every time somebody goes and fills up their tank. But what I have heard from commercials and a lot of farmers is that it doesn't serve the same purpose, some of the markets that it used to, that there is so much volatility that they can't get into the markets. Earlier I talked about overnight trading and when folks in Tennessee wake up and want to trade cotton sometimes but the market is limit up or limit down. And I don't want to pick on just cotton. This happens in a number of the commodities. So it is a concern that the function, Congressman, that you talked about has been changing. And that is why it is up to us to try and figure out what is going on with the speculative influence and it is not really just a black and white issue as much as people want to portray it as that. And it is also why we need to look at things like these cheetah traders that I have talked about. And I know I keep raising it, but when you—can you believe that no place in our regulations, no place in Dodd-Frank are the words "high frequency trading." So this is something very new and it is another thing we have to look at.

Mr. WELCH. I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. Thanks, Mr. Welch. Mr. Crawford for 5 minutes.

Mr. CRAWFORD. Thank you, Mr. Chairman. This question is actually directed to both Commissioners and you can decide who or both of you may want to respond. As I understand it, implementation of rules and regulations in the time frame that we are currently operating under will make regulatory arbitrage a very real threat to U.S. markets in various capacities. It is unclear to me, however, how this might affect various market participants. Would there be any short or long term consequences to end-users such as farmers who are long actuals in the markets if this threat materializes?

Mr. CHILTON. Yes, I am concerned in general about how the markets have shifted, Congressman, and the impact on end-users. You know, if you had to say why do we have these markets, I would say one, it was for the ability for hedgers to—from commercial end-users, to farmers, to people that have an underlying interest in the physical commodity grown: corn, or beans, or cotton, whatever—it is a vehicle for them to hedge. And two, would be to level out prices for consumers so that they aren't paying hardly anything at harvest time and paying a lot at planting time. And I think the markets, as I said earlier, I think they operate efficiently and effectively, but we need to watch out for these changes that are occurring. And so I would agree that we need to look at it and do a better job, I think.

Mr. CRAWFORD. Did you want to add to anything, Commissioner?

Ms. SOMMERS. Yes, Congressman, I think what I would say is as we move forward promulgating all the rules that we are required to promulgate under Dodd-Frank; we have to consider the costs to all of the market participants. So if the cost of doing business increases dramatically in the United States, of course they are going to pass that on to end-users, to the customer, to the consumer. I think there is no doubt that new regulation has costs associated with it, but we need to keep in mind those costs as we are moving forward to make sure that we are doing everything we can in the most efficient and effective way so that we are not overly burdening market participants.

Mr. CRAWFORD. Well, I see—and if you will indulge me for just a minute, you mentioned the cotton market, Commissioner Chilton. And I have watched that very closely. I come from a pretty heavy cotton area in the Arkansas Delta and we lost some pretty big players as a result of some instability a few years ago. And that had to do with limits up over several days. And my concern is that *bona fide* hedgers, and those are the farmers in my district, whether it be cotton farmers, rice farmers, soybean, whatever, are losing their real price discovery mechanism that allows them to plan. Certainly, there is fallout that the consumers are going to face because of the issue you just illuminated. At what point do we get to a place where we can rely on that real time price discovery, the open outcry model that has really brought us to the dance thus far. At what point do we get back there, because we have the 24/7 dynamic. We were seeing limits that were off the charts. I mean, in the 700 point limit up for several days in a row that caught two major cotton players and put them out of business. How do we fix these problems and get more capital from *bona fide* hedgers? Because the truth is if you are farming, you are long actuals. You have to offset that risk. I want to see us incentivize those farmers to invest in the short position to hedge the risk, but they are not wanting to do it. They are afraid to do it. When do we get to that point?

Mr. CHILTON. Well, again, Congressman, these markets are changing, the dynamics are changing, the traders are playing; you have speculative interests who were not in these markets before becoming enlarged—to a large extent. You have pension funds, hedge funds, exchange traded funds that put their money in and keep it for a long period of time. That is a dynamic. The cheetah traders I talked about is a different dynamic. And then the 24-hour cycle that several Members have talked about is a dynamic. And so on the IntercontinentalExchange, I think they do a very good job trying to adapt to the market, but they are dealing with a moving target.

I will give you one example in cotton in particular. At the beginning of the year there were a bunch of limit ups. There were—there have been limit ups and lots of limit downs, but at the beginning of the year I think it was until the beginning of February, there were 14 limit ups. And I looked at—had our staff look at it when those occurred. Well, of the 14, 11 occurred before the markets in Washington—in New York even opened up. They were dealt with. Now, you don't want to say that is a bad thing for the business, because that trading was coming from China, a lot of it, and it was adding some liquidity to the markets. But at the same point, people in your state were getting up and saying, "Well, I think I will go trade today. Wait a minute, I can't trade. The market is closed." So they are trying to adapt with all these things and I think they do a good job. But we—they just need to keep at it and so do we.

Mr. CRAWFORD. Thank you, Commissioners, I appreciate it.

The CHAIRMAN. I thank the gentleman for yielding. I insulted one of the twins over there, Mr. Courtney or Mr. Welch when I looked up. So Mr. Welch, I apologize. Mr. Courtney, I apologize. One of you guys got——

Mr. WELCH. All us Irish guys look alike, you know.

The CHAIRMAN. You have very similar haircuts so I will just—sorry about that—and you sit beside each other. Mr. Courtney, for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Chairman, and thank you both Commissioners for being here today and for your testimony. You know I wanted to make one observation about what is going on with your budget. The numbers which were mentioned earlier here today, a number of us sit on the Armed Services Committee and the Pentagon is the number one consumer of fossil fuels in the world. Secretary Mabus during one of his appearances recently observed that every $10 a barrel increase in the cost of oil costs the

Navy $300 million a year in terms of its annual fuel costs. The Air Force, I am sure is even exponentially higher in terms of their fuel consumption.

So the taxpayer actually has some skin in this game in terms of trying to make sure you get your job balanced and functioning because you know we are all paying. And to the extent that there are inefficiencies which Commissioner Chilton talked about because of the excessive volatility, I just think it is incumbent on all of us who set budgets to recognize that for a relatively small investment, the taxpayer will potentially get a much bigger return in terms of stabilizing some of the costs that our military incurs, as well as a whole host of other Federal agencies. And certainly state and local governments are in the same boat as well in terms of their fuel usage.

You know Commissioner Chilton, thank you for your leadership in terms of the testimony on the position limits. I can tell you that back home the end-users in terms of heating oil have basically exited the market. They will not sell lock-in contracts to their customers next winter because they have no confidence that what is going on in terms of the price has any possible connection to supply and demand.

And, I was interested to hear your remarks that there actually have been some—it sounded almost like an MOU with folks in London regarding position limits. And I was wondering again, if you could just sort of talk about that a little bit more. Because certainly that is one of the issues that I am sure our people are nervous about moving too fast.

Mr. CHILTON. Yes, Congressman, good question. Thank you for your leadership. Yes, the IntercontinentalExchange in London, not the one I was talking about a minute ago in New York. A couple of years ago I agreed to stick by our limits should we impose them and give us real time date about the market. So that is a contract on delivery in the U.S. Now, they are not giving us information on their own contracts that are happening in Europe, but on a contract that is delivered in the U.S. They have agreed to do this. And actually, I think it showed a lot of leadership on their part.

Congressman, I did want to—you were giving little facts there and you know it is not just the government and state and local governments, too. The airlines, for example, Don Bornhorst who is a VP at Delta said that for every dollar increase in the cost of crude oil they annualize, it cost them I think it is $300 million. Now, nobody likes paying baggage fees, but you sort of see hundreds of millions of dollars and say that is a significant impact on businesses. It has a significant impact on consumers also, so again, I think it is just getting these things right. On limits, I think we should do it. I think we should have done it back in January. But we will get there eventually, I am confident.

Mr. COURTNEY. The other sort of little factoid that I think you could sort of look at here is that we went through a lot of consternation about extending the tax cuts in December. One of the provisions was to reduce the Social Security payroll tax for employees by two percent. An average American family was calculated to get about $800 in this year in 2011 because of that change. And, when I am talking to a Chamber of Commerce in eastern Connecticut or a senior center, that savings has just been obliterated in terms of what has been going on just in the last few months or so. So the economic bounce that we were hoping to get by getting people some money in their pockets is just getting totally eaten up.

I realize that there are economists who maybe are advising you differently about what is actually happening out there, but I will tell you that the public who pays your salaries and who is looking to us and looking to you doesn't buy it. They just feel that there is no justification for what is going on out there and their whole— sort of the whole momentum of an economic recovery is being undermined. And I would yield back.

The CHAIRMAN. The gentleman yields back. Thanks Mr. Courtney. Mr. Hultgren for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman. Thank you both and sorry it is kind of a busy morning. I know a lot of us have been in and out with some other committee hearings going, as well. So I apologize if you have touched on some of this. I know you have, but maybe not as specifically as I was hoping to hear.

Commissioner Sommers, I just wanted to follow up on some of the discussion of pension funds and impact on pension funds. And I just wanted to drill a little bit more deeply of what you expect the impact or outcome of the different treatment of pension funds that we see here in the U.S. *versus* the EU. Since there is that difference there, what do you see as the outcome of that difference?

Ms. SOMMERS. I think it is a cost to the people who have invested in those pension funds. I am sure there will be somebody on the next panel who can answer this more specifically, but the exemption in the European legislation text is to exempt those pension funds from clearing requirements for I think either 2 or 3 years, and then looking to what should be done with them after that. Dodd-Frank does not give us the ability to do that, so pensions will not be exempted from the clearing requirement in the U.S. So obviously that adds cost.

Mr. HULTGREN. How significant do you think those costs will be? Do you have any sense?

Ms. SOMMERS. I don't.

Mr. HULTGREN. Okay. Switching gears just a little bit. In a March letter to Chairman Gensler, the FSA expressed concern that CFTC's proposal to set a $50 million cap on the amount of capital clearinghouses can require potential clearing members to have, it could actually increase risk to the system. I just wondered do you agree with that? Would it increase risk? And are there any other proposals currently before the Commission that you think may also increase risk to the system?

Ms. SOMMERS. Congressman, I—what I would say about that is I agree that there is a legitimate concern out there from the buy-side that they have not been given access to clearing. And to be able to deal with that concern, there is a provision in Dodd-Frank that requires open access from clearinghouses. What we did to address that is to set a very low threshold for clearing members. We have received public comment on that and will now revisit what the appropriate threshold or what the appropriate number will be before we move to a final rule.

Mr. HULTGREN. Okay. Thank you very much. I yield back.

The CHAIRMAN. The gentleman yields back. Mr. Huelskamp, for 5 minutes.

Mr. HUELSKAMP. Thank you, Mr. Chairman, and I apologize for my tardiness, but I do have a few questions I would like to follow up on and it is a question I asked last time I was here, and asked of the Commissioners or other Commissioners. But is it still the case that in your new rules you have yet to define a *swap dealer* and *end-user?* Have those been defined in regulations yet?

Ms. SOMMERS. Sir, we have proposed definitions for those, yes.

Mr. HUELSKAMP. And the proposed definitions, those are not yet approved by you?

Ms. SOMMERS. They have not been finalized.

Mr. HUELSKAMP. Okay. Then I indicated previously the difficulty with expecting folks to comment on rules that they don't know if they have been impacted yet. Is that still the difficult situation these folks are in?

Ms. SOMMERS. What we did to address that, sir, is when we proposed the definition for *products,* what is a swap, what is not a swap, what—jointly with the SEC, is we reopened a number of other comment files that relied on that definition. So those comment files were opened for an extended 30 days to allow people to look at the product definition and be able to comment on the other proposals as well at the same time.

Mr. HUELSKAMP. But they are still uncertain whether or not it would apply to them, so they are sending in comments such as if they would happen to somehow, sometime apply to me, this would be our comments. Is that generally what they are saying?

Ms. SOMMERS. They would, I assume, be sending in comments based on the rule that we have proposed. So as proposed, what a swap would be that there is no certainty that that is what the final rule will say as to a definition, but they would be commenting with regard to the proposal.

Mr. HUELSKAMP. Okay. That is still difficult for me to understand why we would do it in that manner. Second thing I would like to comment on or ask questions on something you mentioned as I was walking in. And I apologize about—did you mention a cost-benefit analysis of these regulations? And those are—have those been—is that part of the proposed regulations that you put before the public?

Ms. SOMMERS. Sir, within our proposals of—we have complied with Section 15(a) of the Commodity Exchange Act which requires that we consider costs and benefits of proposals. So there is really just kind of cursory language included in those proposals. It is my understanding that as we move forward because we are not prohibited to go further and to actually quantify what the costs would be associated with proposals, that we will be able to do a more thorough economic analysis of our proposals, going forward.

Mr. HUELSKAMP. And you are able to—are you able to do those before you define the actual entities that would be impacted or do you have to await that final rule?

Ms. SOMMERS. I am hopeful that we will include a more thorough economic analysis within any final rules.

Mr. HUELSKAMP. But if you haven't defined *swap, swap dealer, end-user,* how do you do the economic analysis? Are you telling me you need to wait until those definitions have been finalized?

Ms. SOMMERS. The economic analysis based on the definitions would be within that specific proposal. So when we finalize the definition of a *swap dealer,* the economic analysis based on that definition would be within that proposal.

Mr. HUELSKAMP. So then the comments then could not be directed towards the economic analysis given that you have closed the comments on the proposed rule. Is that correct?

Ms. SOMMERS. If the comment had been closed, then they wouldn't have the ability to do that. I think what you may be suggesting, sir, is that the definition should be finalized first and I agree with that.

Mr. HUELSKAMP. So you will finalize the definitions first?

Ms. SOMMERS. I can't give you that commitment. I am hopeful that we would do that.

Mr. HUELSKAMP. Yes, who can give me that commitment? The other Commissioner or two of you? Who would make that—who makes that final determination?

Mr. CHILTON. There would have to be a third one of us here, sir, to make a commitment.

Mr. HUELSKAMP. Could I count on both of you to be two of the three that we need to provide that certainty?

Mr. CHILTON. I believe we need to do these definitions first. I agree with you 100 percent that it is very difficult for us to know what we are doing without doing the definition. And it is an uncertainty that we need to remedy quickly and I also believe—agree with Commissioner Sommers, that we need to do a better job with our cost-benefit analyses. Some of this, in all fairness, is with regard to this OTC world that we don't have a lot of experience in. So I think that is why we have probably given a more cursory view of doing that than we would have like to have done.

Mr. HUELSKAMP. Yes, and I appreciate that commitment. We are looking for number three then and but yes, that is my concern is about the lack of experience with that particular world and its impacts. That is the uncertainty that I think will do considerable damage if we get this wrong. So I appreciate that and the time, Mr. Chairman, thank you.

The CHAIRMAN. The gentleman yields back. I want to thank our panel for coming and spending time with us today. Thank you very much. Mr. Chilton, can I get you to take a question? Well, you have a comment. Go ahead.

Mr. CHILTON. I just wanted to correct the record, Mr. Chairman. I was informed when I talked about the cost for Delta Airlines, a dollar increase is $100 million. I believe I said $300 million. So I just wanted to correct the record.

The CHAIRMAN. It is just numbers, but thank you for correcting the record on that. Mr. Chilton, would you take a question for the record? You made a comment I think earlier about a 64 percent increase in speculation as a result of information you received on a special call authority of ICE. Can you help our staff understand how you computed that—understand how you did it and those kinds of things? Don't do it right now but for the record?

Mr. CHILTON. Yes, we look at——

The CHAIRMAN. Well, if you wouldn't mind, we don't need it just—if you wouldn't mind.

Mr. CHILTON. For the record, on the record, Mr. Chairman, absolutely.

The CHAIRMAN. Because we have another panel and we need to get to those.

Mr. CHILTON. Yes.

[The information referred to is located on p. 112.]

The CHAIRMAN. So thank you very much both for coming today. The comments are helpful and we appreciate it. Ms. Sommers, Mr. Chilton, thank you very much.

Ms. SOMMERS. Thank you.

The CHAIRMAN. We will now move to the second panel who have been waiting patiently for the grilling to cease with our first panel so if you could move. All right, well, let me introduce the panel. The panel and Commission brought a big entourage with them this morning and it clears much of the seating. Our first witness on the second panel will be Mr. Thomas Callahan, the Executive Vice President and Chief Executive Officer of New York Stock Exchange, Liffe U.S., LLC, on behalf of the New York Stock Exchange Euronext from New York. We have Mr. John Damgard, from the Futures Industry Association here in D.C. We have Mr. Thomas Deas, Vice President and Treasurer for FMC Corporation in Philadelphia. We have Ms. Sally Miller, CEO of Institute of International Bankers, right, right. We have Mr. Stephen O'Connor, Managing Director, Morgan Stanley, and Chairman, International Swaps and Derivatives Association, New York, New York. In the interest of full disclosure, my son works for Morgan Stanley in Los Cruces, New Mexico and has absolutely nothing to do with what Mr. Connor's going to say this morning. Put a plug in for my son. And Mr. Larry Thompson, Managing Director and General Counsel for The Depository Trust & Clearing Corporation in New York City.

Before we begin I am going to have to apologize to the panel. I committed to a speech at noon and I am going to have to slip out before you get too—we have Mr. Neugebauer coming back and if he is not here when I have to leave then Mr. Huelskamp will sit in and I have read your testimony—will read your comments from the questions that are answered. I appreciate you coming, putting up with this process of being the second panel. So with that, Mr. Callahan, if you will try to squeeze yours in within 5 minutes that way we will be able to get to everybody.

STATEMENT OF THOMAS F. CALLAHAN, EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, NYSE LIFFE U.S., LLC, NEW YORK, NY; ON BEHALF OF NYSE EURONEXT

Mr. CALLAHAN. Terrific. Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, my name is Tom Callahan. I am the CEO of NYSE Liffe U.S. which is the U.S. futures exchange of NYSE Euronext. The NYSE Euronext group operates 13 securities and derivatives exchanges in six countries. Thank you for holding this hearing today.

As a multinational company with operations in multiple countries, with customers located on every continent, we are particularly grateful for your focus on U.S. competitiveness and the fact of international coordination. We recognize that Dodd-Frank has placed enormous strains on the CFTC resources and we commend the CFTC and its staff for their extraordinary efforts to implement the Act. However, we are concerned that in some instances the CFTC is electing to use its discretionary authority under Dodd-Frank to propose burdensome and unnecessary restrictions that are not consistent with the purposes of Dodd-Frank, and will impair U.S. competitiveness and market stability.

One such example is the CFTC's proposal on registration of foreign boards of trades or FBOTs. Currently, U.S. market participants can access comparatively regulated FBOTs directly from terminals in the U.S., so long as the foreign board of trade has obtained an approval letter from CFTC staff. This is commonly referred to as no action relief. This kind of framework has worked well for years and has benefitted the U.S. market participants through increase in access to global products and liquidity. Dodd-Frank provides the CFTC with discretionary authority to register FBOTs that offer terminal access in the U.S.

However, the CFTC has proposed to use this authority to replace the existing approval regime entirely with a formal registration requirement for all FBOTs offering access in the U.S. We believe this is an unnecessary and burdensome and costly approach. Given the significant resource constraints that the CFTC currently faces requiring each existing no action recipient to resubmit and for the CFTC to re-review previously submitted information seems unwarranted. In addition, this proposal would set a negative precedent for other jurisdictions who could use this proposal as an excuse to erect barriers to access by U.S. exchanges.

The second example is the CFTC's proposed overhaul of the core principles governing designated contract markets or DCM's. In particular, the CFTC proposed to require a DCM to delist a futures contract that fails to maintain average trading volume through the centralized market of at least 85 percent. Just as with FBOT registration, these changes are not mandated by Dodd-Frank. This proposal seems contrary to the goals of Dodd-Frank since it will likely cause market participants to decrease trading on the regulated futures exchanges and increase their trading in OTC swaps.

In addition, the proposal would create an incentive for the trading to move offshore which is not—to places such as Europe which are not contemplating similar requirements. This proposal may inhibit development of liquid markets in new products. These products often require more than the CFTC's proposed 12 month grace period to establish liquidity before they can trade and exchange on a centralized market.

Recall that DCM's or as they are more commonly known, futures exchanges performed remarkably well during the recent crisis. This begs the question of why U.S. exchanges are now being targeted by reforms that potentially disadvantage them in the global marketplace even though Dodd-Frank did not mandate these changes.

A third example of regulation not required by Dodd-Frank is that of ownership restrictions on exchanges. While Dodd-Frank requires the promulgation of rules to address conflicts of interest, it does not require application of rigid ownership percentages or caps. Nonetheless, the CFTC is considering arbitrary ownership limits for DCMs. These restrictions may inhibit the creation of new DCMs and DCOs and have negative effects on market competition; certainly not the intended goals of Dodd-Frank. Furthermore, European regulators have not proposed similar ownership restrictions, thereby compromising the ability of U.S. and foreign exchanges to operate across borders.

In closing I want to mention two areas where there are significant differences between the CFTC's approach and that of foreign regulators and the SEC. We are concerned that these differences may impair U.S. competitiveness and cross border access for U.S. market participants.

First, the CFTC's proposal on swaps execution facilities or SEFs have significant differences both at the SEC's parallel proposal and the proposal of EU and other jurisdictions. For example, the SEC and the CFTC do not seem to agree on how many participants must receive a quote transmission in an RFQ transmission. Finally, the timing and scope of the clearing for OTC derivatives in the U.S. should coordinate with the rest of the G20. As it currently stands, the clearing mandate for OTC derivatives will likely take effect in the U.S. prior to those mandates being established in other jurisdictions potentially incentivizing swap trading by market participants in foreign markets not yet subject to a clearing mandate. Thank you and I look forward to any questions you may have.

[The prepared statement of Mr. Callahan follows:]

PREPARED STATEMENT OF THOMAS F. CALLAHAN, EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, NYSE LIFFE U.S., LLC, NEW YORK, NY; ON BEHALF OF NYSE EURONEXT

Chairman Conaway, Ranking Member Boswell, Members of the Subcommittee. My name is Tom Callahan, and I am the Chief Executive Officer of NYSE Liffe U.S., LLC ("NYSE Liffe U.S."), a subsidiary of NYSE Euronext. The NYSE Euronext group operates 13 securities and derivatives exchanges in six countries.[1] NYSE Liffe U.S. is a futures exchange designated by the Commodity Futures Trading Commission ("CFTC") as a contract market ("DCM"). I am pleased to appear this morning on behalf of NYSE Euronext and its affiliated exchanges as the Subcommittee considers both the progress towards and challenges to international harmonization in connection with the implementation of the derivatives title of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").

We believe that the reduction of systemic risk and the enhancement of transparency through expanded use of clearinghouses and organized trading markets are important objectives. The adoption of these and related goals by the Group of Twenty ("G20") countries is also a key and indeed critical element in enabling us to accomplish these objectives. As a multinational company with exchange operations in multiple countries, and customers located on every continent, we are acutely aware that effective international coordination is critical both to the accomplishment of Dodd-Frank's intended results as well as to the commercial success and competitive positioning of U.S. exchanges, clearinghouses and other market participants.

Effective global coordination will have the salutary effects of preventing regulatory arbitrage, improving market efficiency and raising the quality of regulatory oversight in all participating jurisdictions. Ineffective coordination of regulatory policy, however, will lead to market fragmentation. Where that occurs, U.S. end-users and investors could be disadvantaged both in accessing foreign markets and in their ability to trade in liquid U.S. markets.

We believe there are three key dimensions to effective global coordination: first, working cooperatively to establish coordinated regulatory policy at the international

[1] NYSE, NYSE Arca Equities, NYSE Arca Options, NYSE Amex Equities, NYSE Amex Options, NYSE Liffe, NYSE Liffe U.S., NYSE Blue, NYSE Alternext Equities, Euronext Paris, Euronext Brussels, Euronext Amsterdam, and Euronext Lisbon.

level; second, establishing an appropriate framework for cross-border market access that does not require regulators to assume unrealistic and unduly costly extraterritorial regulatory obligations that they are not positioned to discharge effectively; and third, adopting a mutual recognition framework for comparable foreign regulatory regimes recognizing that comparable policy objectives may be realized through varying regulatory mechanisms.

We believe that the CFTC's traditional approach to recognition of comparable foreign regulatory regimes has worked well over the years, but we have some concerns that its proposals under Dodd-Frank would unduly depart from that approach. Before addressing those specific proposals, however, I would like to highlight two overriding principles that we believe should inform the CFTC's and the Securities and Exchange Commission's (SEC) implementation of Dodd-Frank:

- First, we believe that Dodd-Frank should not serve as a basis for the CFTC (or the SEC) to take on unnecessary and inappropriate extraterritorial regulatory obligations. Rather, Dodd-Frank should serve as a basis to supplement the CFTC's existing approach to cross-border market access through the use of new authorities to address clearly evasive activity. In this regard, extraterritorial jurisdiction is only appropriate where legitimate U.S. regulatory concerns exist, such as where foreign markets offer "look-alike" products that are linked directly to contracts traded on U.S. DCMs and that may be used to circumvent important U.S. regulatory objectives. However, any such exertion of extraterritorial jurisdiction should be narrowly tailored to preventing such circumvention. As a corollary, permitting U.S. investors to access foreign markets on an appropriate basis is critical if U.S. market providers are to be permitted to access investors outside the United States on appropriate and commercially viable terms.
- Second, it is critical that the CFTC, where possible, seek harmonization—or, at a minimum, comparability—with other regulators in implementing derivatives reforms. Significant differences with foreign regulators, particularly the European Union ("EU"), and domestically with the SEC, could preclude the establishment of an effective comparability-based framework for cross-border access. This will in turn encourage regulatory arbitrage that can only be addressed, at a significant cost to market participants, through steps that will invariably fragment markets regionally and foster illiquidity and increased costs of execution. Harmonization and comparability, in contrast, will protect the international competitiveness of U.S. exchanges, clearinghouses and other market professionals and ensure U.S. market participants have cost effective access to critical risk management products.

1. Cross-Border Market Access

A. Access to Foreign Markets

Currently, U.S. market participants can access comparably regulated foreign boards of trade ("FBOTs") directly from terminals in the U.S. This access has been permitted by the CFTC under a long line of no-action relief. The NYSE Liffe markets in London and Paris have been open to U.S. market participants under this system since 1999, and the Amsterdam market has been open to U.S. market participants since 2005. Not only has this existing approval process proven effective at expanding the range of products available to U.S. market participants, increasing liquidity, and lowering costs, but it also has given the CFTC a great deal of flexibility in terms of tailoring relief to particular markets and modifying the conditions for such individual operations over time. This framework for cross-border access has worked well since its inception, benefitting U.S. market participants.

Dodd-Frank provided the CFTC additional flexibility in the form of discretionary authority to directly register FBOTs that offer terminal access in the U.S. While we appreciate that adoption of a rules-based standard may be useful as a supplement to the existing no-action regime, particularly for FBOTs that offer "look-alike" contracts that are linked directly to contracts traded on U.S. DCMs, we are concerned that replacing the no-action regime entirely with a registration requirement for all FBOTs offering access in the U.S. is unnecessary and unduly costly.

Pursuant to this authority, the CFTC has proposed to require the registration and oversight of FBOTs that provide qualifying U.S. persons with direct electronic access to their trading and order matching engines. The proposed approach would represent a striking departure from the CFTC's existing regime, which has been influential in encouraging other jurisdictions to look to comparable U.S. regulation as a basis for mutual recognition.

In particular, given the significant resource constraints the CFTC faces in implementing Dodd-Frank, the CFTC's proposal to require each existing no-action recipient to re-submit, and the CFTC to re-review, information that was already reviewed by CFTC staff in connection with the original approval seems especially unwarranted. It would also impose unnecessary costs and burdens on foreign applicants.

The CFTC's proposal, if adopted, would also set an undesirable precedent for other jurisdictions, such as the EU, which are considering permitting U.S. market operators to operate abroad on a mutual recognition approach.

B. Access to U.S. Markets

In the futures markets, the CFTC has traditionally allowed foreign market participants and intermediaries to access U.S. Designated Contract Markets ("DCMs") without subjecting them to direct CFTC regulation so long as they, like U.S. customers, access the DCM through a CFTC-registered futures commission merchant. While the CFTC has proposed to extend this approach to swaps at the intermediary level, there are still questions about whether a foreign market participant can trade swaps on a U.S. DCM or swap execution facility ("SEF") without becoming subject to regulation as a swap dealer or major swap participant. So that we can, in the future, offer trading in swaps on NYSE Liffe U.S. to both U.S. and foreign market participants—thereby attracting the greatest amount of liquidity—we believe it is important for the CFTC to clarify this point.

2. Harmonization and Comparability

In order for any mutual recognition regime to work—and to avoid undesirable arbitrage between U.S. and foreign markets and different types of U.S. markets—regulators must take care to adopt consistent approaches to similar issues or at least recognize where different means can be used legitimately to achieve common objectives. These principles have, for over twenty years, been implicit in the CFTC's own approach to comparability under Part 30. We are concerned, however, that the CFTC's current proposals for DCMs, including ownership restrictions, might lead to an unwarranted departure from those principles; the approaches being proposed for the regulation of SEFs are inconsistent; and we also believe it is important that the CFTC coordinate with other G20 jurisdictions on key aspects of reform, including clearing mandates and swap data repositories ("SDRs").

A. Designated Contract Markets

The CFTC has proposed a substantial overhaul of the core principles governing DCMs, including proposing to require a DCM to delist a contract that fails to maintain average trading volume through centralized markets of at least 85%. These changes are not mandated by Dodd-Frank and will likely have a significant negative impact on the competitiveness of U.S. DCMs. In the U.S., market participants may increase their trading in swaps that offer futures-like exposure, including on SEFs. In the EU, current reform proposals do not contemplate any such requirements, thus creating an incentive for derivatives trading to move offshore to European exchanges.

The proposed 85% central trading threshold is particularly problematic because it may inhibit the development of liquid markets in new products, which are often initially traded outside of centralized markets and often require more than the proposed 12 month grace period to establish adequate liquidity. Trading in these products will almost surely move to SEFs and offshore—thereby eliminating the still significant price discovery function played by block transactions that are executed subject to the rules of DCMs. The potential migration of these existing contracts away from DCMs seems completely contrary to the goals of Dodd-Frank and will likely have serious ramifications for market participants with open positions in affected contracts, disrupting effective risk management strategies by reducing contract liquidity and in some cases requiring market participants to hold existing positions to expiration. There are significant adverse market and risk management effects of applying an arbitrary and inflexible standard.

B. Ownership Restrictions

The CFTC is considering substantial restrictions on the ownership of DCMs and SEFs which may inhibit the creation of new DCMs and SEFs and have deleterious effects on market competition. These effects are magnified by the significant capital requirements for DCMs also mandated by the CFTC. Moreover, European regulators have not proposed similar ownership restrictions for exchanges operating in Europe, compromising the ability of U.S. and foreign exchanges to operate across borders in any future comparability-based cross-border framework.

We acknowledge that potential conflicts of interest can raise potentially serious issues and we applaud the CFTC for its leadership in addressing these concerns. However, we feel strongly that the consistent oversight of compliance with the existing core principles, CFTC rule approval requirements and other safeguards provide substantially better tools to mitigate potential conflicts than blunt ownership limitations that could stifle innovative solutions and new ventures. The market is too diverse to become subject to a one-size-fits-all approach to conflicts. Rather, different market models must be allowed to develop for different products. For these market models to develop in a successful and transparent manner, a broad range of market participants must have input. This will allow for greater competition and innovation in areas such as cross-margining arrangements and trading functionalities.

C. Swap Execution Facilities

The CFTC's proposal for SEFs has significant differences both with the SEC's parallel proposal and proposals in the EU and other G20 jurisdictions. These differences may impair the competitiveness of U.S. markets, encourage trading elsewhere and restrict the effectiveness of any comparability-based cross-border regime.

D. Clearing Mandate

The timing and the scope of the clearing mandate for OTC derivatives in the U.S. should be coordinated with the rest of the G20. As it currently stands, the clearing mandate for OTC derivatives will likely take effect in the U.S. prior to those mandates being established in other jurisdictions, potentially incentivizing swaps trading by market participants in foreign markets not yet subject to a clearing mandate. Moreover, eventually, cross-border swap transactions may be subject to clearing mandates in more than one jurisdiction, with potentially conflicting requirements. The CFTC should work together closely with foreign regulators to develop a framework for regulatory cooperation that avoids such conflicts. For instance, the CFTC should facilitate the clearing of swaps by U.S. market participants on clearing organizations outside the U.S. that are subject to comparable regulation, so as to foster reciprocal treatment from foreign regulators and promote an efficient, transparent global market.

E. Swap Data Repositories

Dodd-Frank requires Swap Data Repositories (SDRs) to obtain an agreement for indemnifications from foreign regulators before sharing information regarding swaps transactions. This requirement is contrary to existing approaches to information sharing and, in our view, unduly burdensome. Dodd-Frank also does not grant the CFTC express authority to exempt a comparably regulated foreign SDR, which is inconsistent with proposals in the EU and elsewhere. Left unaddressed, these issues will contribute to regional fragmentation of global information collection and impede the CFTC's exercise of its regulatory responsibilities under Dodd-Frank.

While we would support statutory changes to address these SDR concerns, we also believe that the CFTC could address them through its rulemaking and interpretive authority. The CFTC could, for instance, address the indemnification issue by interpreting the indemnification provision not to apply where information is provided, either directly or through the CFTC, pursuant to a CFTC Memorandum of Understanding with a foreign regulator. The CFTC could also adopt a notice registration regime for comparably regulated foreign SDRs that fulfills the statutory mandate without requiring the CFTC to directly regulate SDRs already regulated abroad.

3. Conclusion

We recognize that the passage of Dodd-Frank has placed enormous resource burdens on the CFTC, and we commend the CFTC and its staff on their proactive and timely efforts to nevertheless implement the many required rulemakings under Dodd-Frank. As a globally integrated company whose operations are often subject to overlapping regulatory regimes and requirements, we are particularly concerned about a number of CFTC proposed rules that would impede appropriate cross-border market access by U.S. or foreign persons as well as those that may thwart the development of comparability-based mutual recognition or exemption regimes. We have highlighted a number of these concerns today in this testimony.

Going forward, we strongly believe that the CFTC should develop its final rules under Dodd-Frank, as well as utilize its other rulemaking and interpretative authorities, in light of two primary objectives. First, the CFTC should not view Dodd-Frank as an opportunity to expand extraterritorial application of U.S. law—or to establish the need for resources to administer a global examination and supervisory reach—unnecessarily, especially in light of the significant resource constraints the CFTC already faces and the history of successful comparability regimes. Second, the CFTC should seek actively to harmonize its derivatives reform rules with the SEC and with regulators in other G20 countries in order to discourage regulatory arbitrage and facilitate the development of comparable international regulatory frameworks and to avoid market fragmentation and other inefficiencies.

The CHAIRMAN. Mr. Callahan, thank you very much. I appreciate that. It was not lost on me when Chairman Chilton, Commissioner Chilton in fact bragged on the regulated markets as having had no function properly during the crisis in late 2008. So it does beg the question as to why they are—expansive work in that regard. Mr. Damgard for 5 minutes. Thank you, sir. We appreciate you being here.

STATEMENT OF JOHN M. DAMGARD, PRESIDENT, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, D.C.

Mr. DAMGARD. Thank you, Mr. Chairman. I thank—I join Mr. Callahan in thanking you all, and I thank the Members of the Committee for having this hearing and inviting me to speak. I am John Damgard. I am President of the Futures Industry Association. I am also soybean and corn producer from Illinois. And on behalf of the FIA, I want to thank you for the opportunity to appear here today.

I share your concern about extraterritorial impact of the Dodd-Frank Act and the importance of international regulatory harmonization. In my testimony today, I will discuss two specific rulemakings that exemplify these issues, but first I would like to take a moment to put these issues into a broader context. It was not so long ago the derivatives markets in general, and futures markets in particular, were viewed as secondary to other aspects of modern finance such as trading of stocks and bonds. That is clearly no longer the case. Derivatives markets will be as important in the financial markets of the 21st century as the stock exchanges were in the 20th century preserving our ability to compete in the global derivatives marketplaces, therefore, critical to our economic standing in the world.

As the President of the FIA, I can assure you that the global derivatives marketplace is becoming more and more competitive every year. Our statistics on trading volume show that last year North America was outstripped by the Asia Pacific region in terms of the number of futures and the options that trade on their exchanges. At the moment, the largest exchanges in the region draw most of their volume from domestic customers, but it is only a matter of time before they open to the outside world, and when they do our markets will be challenged like never before. I might add that the Dalian Commodity Exchange is now the largest agricultural futures market in the world.

In our industry, liquidity is the key to success. Anything that adds to the cost of doing business on our markets creates an economic incentive to use an alternative or not any at all. No matter how well-intended, Dodd-Frank punished the U.S. futures industry, an industry that had absolutely no responsibility for the financial crisis and indeed worked flawlessly throughout the entire period. If Dodd-Frank makes our markets less efficient and more expensive we run the risk of pushing another industry off shore.

Let me give two examples of specific rule makings with adverse extraterritorial impact and on this I agree with Mr. Callahan. The first example with—relates to the cross border clearing of swaps. Under Dodd-Frank any non-U.S. clearinghouse that clears swaps for participants in the U.S. must be registered with the CFTC as a derivatives clearing organization. In addition, any firm that is a member of that foreign clearinghouse must register with the CFTC as an FCM, a futures clearing if it clears swaps on behalf of U.S. customers.

Let us think about the practical implications of that position. Adding these clearing organizations to the Commission's oversight responsibility will severely strain the agency's resources and put a substantial and unnecessary financial and operational burden on FCM's. Some firms and clearing organizations could well decide it just isn't worth the trouble. The net effect will be fewer choices for U.S. customers who need access to clearinghouses for their swaps. There is also the risk that foreign regulators will follow our lead and impose burdensome requirements on our firms, an outcome that none of us would like to see called retaliation.

In our view, the logical solution is to rely on the successful model now in place in the futures markets. The CFTC's part 30 rules which govern the offering for sale of foreign futures to U.S. participants do not require either a foreign clearing organization or its clearing members to be registered with the CFTC if they are subject to comparable regulation in their home country. This approach has worked extremely well and has facilitated the ability of U.S. FCMs and their customers to participate in international markets.

The second example is the CFTC's proposed rule for position limits. I want to emphasize that the CFTC strongly supports robust large trader reporting requirements which assure that the CFTC and other regulators have complete visibility into the activities of the more active traders. Our concern is that the lack of international harmonization on position limits threatens to place U.S. markets and market participants at a severe competitive disadvantage.

Furthermore, the proposed rules do not satisfy the statutory prerequisites for establishing position limits. No evidence has been cited by the CFTC to justify position limits as necessary to diminish, eliminate, or prevent excessive speculation. Unsupported claims about the effect of speculation should not be allowed to undermine the price discovering and risk shifting function of the U.S. derivative markets, or cause these markets to shift to foreign boards of trade.

Just today, the FIA filed a comment letter requesting that the CFTC republish the position on the rules with information on how the agency intends to apply the rule governing aggregation of positions. If applied as written, this rule will stifle legitimate use of the markets by investors and end-users. We urge the CFTC to republish this proposal so that the public will have appropriate notice and the opportunity to comment on aggregation of positions.

In closing, I would like to raise a procedural concern. Chairman Gensler has correctly observed that the proposed rules fit together in a mosaic. Mosaics however, are nothing more than chips of colored stone until they have been pieced together into a work of art. The Commission has shown us the individual chips, but it hasn't shared its vision of how they fit together in a comprehensive regulatory scheme. The industry and the public deserve an opportunity to analyze and comment on this regulatory mosaic before it is set in concrete and takes its final form. We therefore recommend that the Commission provide an additional 60 day comment period after it has determined how the proposed rules fit together and before it promulgates these rules. We think a 60 day comment period would be well within the time table set by the G20. Thank you very much for my opportunity to appear before you today.

[The prepared statement of Mr. Damgard follows:]

PREPARED STATEMENT OF JOHN M. DAMGARD, PRESIDENT, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, D.C.

Chairman Conaway, Ranking Member Boswell, Members of the Subcommittee, I am John Damgard, President of the Futures Industry Association (FIA). On behalf of FIA, I want to thank you for the opportunity to appear before you today.

When Congress was considering the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), many in the financial services industry—and in Congress—cautioned that the extraterritorial reach of the regulatory structure being established would unnecessarily interfere with the regulatory programs being established in the European Union and Asia and would inhibit the ability of U.S. market participants to compete internationally. As we approach the effective date of the Dodd-Frank Act, and the regulatory regime contemplated by the Commodity Futures Trading Commission (Commission) in its proposed rules has come into focus, there is increasing evidence that last year's hypothetical fears will be this year's reality.

Concern Over the Extraterritorial Scope of the Commission's Rules Is Increasing

In March, the UK Financial Services Authority (FSA) filed a comment letter with the Commission objecting to the Commission's proposed rules prohibiting registered derivatives clearing organizations (DCOs) from setting minimum capital requirements for swap clearing members higher than $50 million. While acknowledging that minimum capital requirements may help assure fair and open access to clearing organizations, FSA warned that "impos[ing] them on clearing arrangements for products that have complex or unique characteristics could lead to increased risk to the system in the short to medium term." FSA has a direct interest in the Commission's rules affecting DCOs, since two registered DCOs active in clearing swaps—LCH.Clearnet Ltd. and ICE Clear Europe—are located in London and are subject to regulation by FSA as recognized clearing houses. Therefore, the Commission's requirements for DCOs may conflict with FSA's.

Earlier this month, Paula Dejmek, a Member of the Cabinet of Michael Barnier, the European Commission's internal market and services commissioner, speaking at a conference of the Association for Financial Markets, observed:

> We are aware of the extraterritorial application of the Dodd-Frank Act. We are not happy with it and this is something we are discussing with our U.S. counterparts, hoping to find mutually convenient solutions. . . . The issue of regulatory convergence is extremely important. . . . We have important questions to address, notably with regard to the mutual open access to each other's market operators and infrastructures.

International regulators are not the only authorities troubled by the extraterritorial reach of the Dodd-Frank Act. Just last week, Senators Schumer and Gillibrand joined 16 Members of the New York House of Representatives both Democrats and Republicans, including Congressman Gibson and eight Members of the House Financial Services Committee, to express their fears that the Commission's proposed rules imposing margin requirements on uncleared derivatives transactions between non-U.S. subsidiaries of U.S. entities and non-U.S. counterparties:

> will inevitably result in significant competitive disadvantages for U.S. firms operating globally. . . . [A]bsent harmonization between new rules here and abroad, disparate treatment of U.S. firms will only encourage participants in derivatives markets to do business with non-U.S. firms. Accordingly, it is important to strike a balance between implementing the new safeguards and harming the competitiveness of U.S. financial institutions *vis-à-vis* their international counterparts. . . . Congress . . . included provisions in Dodd-Frank that instruct regulators . . . to impose regulations extraterritorially beyond the U.S. only if there is a 'direct and significant' connection with U.S. activities or commerce. These provisions are intended to protect . . . the competitiveness of U.S. institutions, which is necessary for a healthy banking system.

We do not underestimate the challenges facing the Commission, and we recognize that the Commission and its staff are working hard to comply with the very tight timeframes set out in the Dodd-Frank Act. It is perhaps understandable, therefore, that the Commission has not considered fully, and provided guidance on, the intended extraterritorial scope of the Dodd-Frank Act. As the above examples indicate, however, the Commission cannot wait any longer.

Guidance on the Extraterritorial Scope of the Commission's Rules Is Essential

Many provisions of the Dodd-Frank Act do not require implementing rules and will become effective in less than 2 months. The failure of the Commission to provide clear guidance on the extraterritorial scope of the Dodd-Frank Act prior to its effective date, and the resultant legal and regulatory uncertainty to which market facilities and participants both here and abroad will be exposed, will require such participants to incur significant costs to comply with the Dodd-Frank Act or assume the regulatory risk that they will be found to be in violation of one or more provisions of the Dodd-Frank Act and, perhaps, ordered to cease business activities until they are in compliance. No market facility or participant can afford to take this risk.

One example that I would like to highlight for you today that directly affects many FIA members are the provisions of the Dodd-Frank Act requiring any clearing organization, wherever located, that clears swaps for participants located in the U.S. to be registered with the Commission as a DCO and the concomitant obligation of any clearing member clearing swaps on behalf of U.S. participant to be registered as an FCM.

Section 725 of the Dodd-Frank Act provides that it is unlawful for any clearing organization "directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a derivatives clearing organization with respect to . . . a swap," unless that clearing organization is registered with the Commission as a DCO. On its face, therefore, this section requires a foreign clearing organization to be registered as a DCO if it cleared just one swap for or on behalf of a U.S. participant. This is the case even if the Commission has not determined that the swap is required to be cleared.

Section 724 of the Dodd-Frank Act provides that it is unlawful for any person to accept any money or securities "from, for, or on behalf of a swaps customer" to margin a cleared swap, unless that person is registered with the Commission as an FCM. Consequently, a clearing member of a foreign clearing organization that clears swaps, directly or indirectly, on behalf of one or more U.S. swap participants is required to be registered with the Commission.

Requiring the registration of such foreign DCOs threatens to: (i) severely strain the Commission's resources; (ii) impose substantial financial and operational burdens on FCMs, subjecting FCMs to duplicative and conflicting laws and regulatory requirements; (iii) restrict competition among clearing organizations and FCMs; and (iv) enhance rather than reduce systemic risk.

In his testimony before the House Appropriations Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies in March, Chairman Gensler stated that the Commission currently oversees 14 registered DCOs and anticipates that the Dodd-Frank Act will result in an additional six or seven clearing organizations applying for registration as a DCO. Consequently, the Commission is requesting a 30 additional staff, in addition to the current staff of 40, "to address the significant increase in the number of DCOs, the more complex nature of the swaps markets and the Congressional mandate that we annually examine systemically important DCOs."

Providing appropriate exemptions from registration to foreign clearing organizations whose activities do not have "a direct and significant connection with activities in, or effect on, commerce of" the U.S. would relieve the Commission of the cost of overseeing such foreign clearing organizations and free staff to focus on transactions that more directly affect U.S. market participants. An exemption would also permit such clearing organization to offer clearing services to U.S. participants without having to incur the costs of applying for registration and, thereafter, meeting duplicative and potentially conflicting regulatory requirements of the Commission and its home country regulator.

Importantly for our member firms, an exemption from registration as a DCO would relieve U.S. FCMs of the difficult choice of complying with multiple financial and operational requirements attendant to membership in clearing organizations around the globe or choosing not to offer the broad range of swaps clearing services to customers. Moreover, such firms may have to become registered in the home jurisdiction of the foreign DCO and, potentially, become subject to taxation in multiple jurisdictions.

As the Subcommittee is aware, one of the principal purposes of the Dodd-Frank Act is to encourage competition among clearing organizations and clearing members. Requiring each foreign clearing organization that clears swaps for or on behalf of U.S. participants to become registered as a DCO and each clearing member that, directly or indirectly, clears for U.S. participants to become registered as an FCM will almost certainly restrict rather than encourage competition. Requiring U.S. FCMs to become registered with multiple foreign DCOs may also enhance systemic risk, by exposing such FCMs to the risks of being members of clearing organizations that are subject to different regulatory regimes and bankruptcy laws.

As noted earlier, two of the more active swaps clearing organizations registered with the Commission, ICE Clear Europe and LCH.Clearnet Ltd., are located outside of the U.S., and we fully expect that other foreign clearing organizations will elect or be required to be registered with the Commission as DCOs. Certainly, any foreign clearing organization that elects to apply for registration as a DCO should be permitted to apply. However, we do not believe every foreign clearing organization that clears swaps, directly or indirectly, for or on behalf of U.S. participants should be required to be registered simply because it offers clearing services to U.S. participants.

A Successful Model for the Regulation of Foreign DCOs

This does not need to be result. We agree with the New York Congressional Delegation that the Dodd-Frank Act should not apply to activities outside of the U.S., *i.e.,* clearing on a foreign clearing organization, unless such clearing activities have "a direct and significant connection with activities in, or effect on, commerce of" the U.S. We believe the Commission has authority to interpret this provision to exclude from its jurisdiction certain entities and transactions that do not have a significant impact on that do not have a significant impact on U.S. commerce. Moreover, the Commission has specific authority under the Dodd-Frank Act to exempt a foreign clearing organization from registration as a DCO, subject to appropriate conditions, if the Commission determines that the foreign clearing organization is subject to comparable, comprehensive supervision and regulation by the appropriate government authorities in the home country of such organization.

The Commission's Part 30 rules, which govern the offer and sale of foreign futures and options transactions to U.S. participants, is a tested, successful model for the regulation of international transactions that could serve as a starting point for exempting foreign clearing organizations and other market participants from the Commission's registration requirements. The Commission's Part 30 rules were first promulgated nearly 24 years ago in 1987. Under these rules, foreign clearing organizations are not required to be registered with the Commission to clear futures contracts executed on foreign exchanges on behalf of U.S. participants. In addition, a foreign clearing member is not required to be registered with the Commission as an FCM, if the foreign clearing carries only a customer omnibus account on behalf of a U.S. FCM and does not carry an account directly for a U.S. customer.

These rules assure that the accounts of U.S. participants are carried by U.S. FCMs, subject to the Commission's rules regarding the protection of foreign futures and options customer funds, as well as the Commission's sales practice and other requirements to which FCMs are subject. Customers that trade on non-U.S. markets also receive prescribed risk disclosure, which assures that they understand the additional risks of trading outside of the U.S.

Further, the Commission's Part 30 rules provide that a foreign clearing member may deal directly with FCMs and their affiliates without having to be registered with the Commission as FCMs. Having determined that a foreign clearing member is not required to be registered as an FCM to carry a U.S. FCM's customer omnibus account, the Commission concluded that registration would not be required to clear the U.S. FCM's proprietary accounts. The Commission concluded that U.S. FCMs are able to assess the risks of trading on foreign markets.

Finally, under the Part 30 rules, the Commission has granted exemptions from registration to non-U.S. firms that deal with U.S. customers and that the Commission determines are subject to comparable regulation in their home country.

When I appeared before you in February, I noted:

> Because Congress gave the regulatory agencies, including the Commission, broad discretion in adopting rules to implement provisions of the Dodd-Frank Act, it is essential that the Committee on Agriculture, as the Committee of jurisdiction with respect to matters relating to the [Commodity Exchange Act], monitor carefully the Commission's implementation of the Dodd-Frank Act and provide additional guidance when appropriate.

FIA urges the Subcommittee to encourage the Commission to exercise its interpretative and exemptive authority broadly in order to facilitate U.S. FCM participation in the development of international cleared swaps markets. The Commission must act now; if it waits until the end of the rulemaking process, it will be too late.

Exemptive Relief Will Facilitate Coordination Among International Regulators

By granting appropriate exemptive relief, we believe the Commission will facilitate greater coordination among international regulators and the establishment of consistent standards with respect to the regulation of swaps. The need for such coordination has been brought into sharp relief with reports that the European Parliament is considering amendments to the European Union's European Market Infrastructure Regulation ("EMIR"), which would effectively prohibit a third-country clearing organization from providing clearing services to EU entities, unless the clearing organization was authorized by each EU member state. Moreover, a third party clearing organization could be authorized only if the European Commission recognized that the legal and supervisory arrangements of its home jurisdiction were "equivalent" to those contained within EMIR.

If the European Parliament adopts these amendments, it would be extremely difficult, if not impossible, for U.S. DCOs to offer their clearing services to entities within the EU. The "balkanization" of derivatives clearing in this way benefits no one, denying market participants access to clearing, reducing competition and increasing global systemic risk. Yet, the Commission's ability to challenge these amendments will be severely constrained if the Dodd-Frank Act is interpreted to require EU clearing organizations to be registered here to offer clearing services to U.S. participants.

The Commission has been a leader in developing standards for mutual recognition among international regulators for more than 20 years. The Dodd-Frank Act should not be interpreted in a manner that requires the Commission to surrender this leadership role.

Position Limit Rules Must Be Harmonized

In their letter to Chairman Gensler, the New York Delegation noted:

> [A]bsent harmonization between new rules here and abroad, disparate treatment of U.S. firms will only encourage participants in derivatives markets to do business with non-U.S. firms. Accordingly, it is important to strike a balance between implementing the new safeguards and harming the competitiveness of U.S. financial institutions *vis-à-vis* their international counterparts.

I would like to take a moment to address one aspect of the Commission's proposed rules with respect to which the lack of international harmonization threatens to place U.S. markets and market participants at a severe competitive disadvantage, *i.e.,* position limits. FIA fully supports a robust large trader reporting system across markets. It is important that the Commission and other regulatory agencies and self-regulatory organizations know the identity of market participants with meaningful positions. However, we cannot support the proposed position limit rules.

FIA filed extensive comments in response to the proposed rules in which we argued, among other things, that the proposed rules do not satisfy the statutory prerequisites for establishing position limits. Specifically, in publishing the proposed rules for comment, the Commission cited no evidence for concluding that position limits are "necessary to diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation, or that the levels proposed by the Commission are "appropriate."

We also expressed concern over the public policy considerations of imposing significant new restrictions on the ability of market participants to trade listed and over-the-counter derivatives without adequate factual support for those restrictions. The price discovery and risk-shifting functions of the U.S. derivatives markets are too important to U.S. and international commerce to be the subject of a position limit experiment based upon unsupported claims about price volatility caused by speculative positions.

Equally important, we are concerned that the proposed rules could cause non-U.S. participants that currently use U.S. futures and derivatives markets to trade and manage their commercial or financial risks will shift their trading activities to locations outside of the U.S., which do not have position limits. As the Subcommittee will recall, the Dodd-Frank Act requires the Commission, within 12 months of adopting any position limits to "conduct a study of the effects (if any) of the position limits imposed . . . on the movement of transactions from exchanges in the United States to trading venues outside the United States." Our fear is that, without the necessary factual predicate, the Commission cannot assure Congress or market participants that the position limits it sets will not adversely cause the price discovery and risk allocation functions that U.S. futures exchanges perform so well to shift to foreign boards of trade.

The Commission's Rules Should Be Published for Additional Comment

FIA has previously expressed to the Subcommittee its concern that the pace and order in which the Commission has proposed rules to implement the Dodd-Frank Act were such that meaningful analysis and comment difficult was difficult, if not impossible. Earlier this month, the Commission announced that it would reopen the comment period on many of the proposed rules for an additional 30 days. We appreciate the Commission's action. However, we are disappointed that the Commission did not share its views on the many thousands of comments it has received to date and, more importantly, how the Commission sees these various rule proposals fitting together to form a comprehensive and coherent regulatory structure.

Chairman Gensler has correctly observed that the numerous rules the Commission has proposed form a mosaic, and he has suggested that this 30 day comment period will allow commenters to see the entire mosaic at once. Mosaics, however, are nothing more than chips of colored stone until they have been creatively assembled to make a work of art. We suggest that the Commission's proposals are still just chips waiting for the Commission to assemble them into a comprehensive regulatory structure. The industry and the public deserve an opportunity analyze and comment on the Commission's vision of its regulatory mosaic before it is set in concrete. We, therefore, recommend that, once the Commission has determined how these various proposed rules will fit together, it provide an additional 60 day comment period before promulgating final rules. We think a 60 day comment period would be well within the timetable set by the G20.

Thank you again for the opportunity to appear before you today. I would be happy to answer any questions you may have.

Mr. NEUGEBAUER [presiding.] Thank you, and now Mr. Thomas C. Deas. Mr. Deas.

STATEMENT OF THOMAS C. DEAS, JR., VICE PRESIDENT AND TREASURER, FMC CORPORATION; PRESIDENT, NATIONAL ASSOCIATION OF CORPORATE TREASURERS, PHILADELPHIA, PA

Mr. DEAS. Thank you and I want to thank Chairman Conaway, Ranking Member Boswell, and Members of the Committee for allowing me the opportunity to speak with you today on derivatives regulation. I am Tom Deas, Vice President and Treasurer of FMC Corporation, and also President of the National Association of Corporate Treasurers.

FMC and NACT are also part of the Coalition for Derivatives End-Users representing thousands of companies across the country that employ derivatives to manage their day to day business risks. FMC Corporation was founded almost 130 years ago to provide spray equipment to farmers. Today, in addition to making agricultural chemicals farmers apply to protect their crops, our 5,000 employees have worked hard to make FMC the leading manufacturer and marketer of a whole range of agricultural specialty and industrial chemicals. FMC has achieved this longevity by continually responding to our customer's needs with the right chemistry delivered at the right price. Along with many other U.S. manufacturers and agricultural producers, FMC uses over-the-counter derivatives to hedge the business risks that we incur in a cost effective way. By managing the risk of foreign exchange rate movements, changes in foreign interest rates, global energy and commodity prices we can compete more effectively in the increasingly global marketplace.

We are very concerned that several of the proposed derivatives regulations, the aggressive schedule for rule making could hamper our use of this important risk mitigating tool and adversely affect our global competitiveness. We support this Committee's efforts to redress the problems with derivatives, and I want to assure you that FMC and other end-users employ OTC derivatives to offset risks not create new ones.

In the United States, FMC sells more crop protection chemicals for soybeans than any other crop. Our ability to continue bringing U.S. farmers new chemistries at the right price and controlling costs on existing products depends on our capacity to compete effectively on a world-wide basis. FMC meets and beats foreign competition in several overseas markets for our crop protection chemicals.

In Brazil, for example, building on our leading position in cotton and sugarcane, we offer to sell our products to soybean farmers there for use at planting time in exchange for an agreed quantity of soybeans that they pay to us at harvest time. We can do this because we simultaneously enter into a custom, over-the-counter derivative that offsets the amount and timing of the future delivery of soybeans by our customers. In a developing country like Brazil, farmers do not have FMC's degree of access to the world-wide financial markets. Our banks did not require FMC to post cash margin to secure mark-to-market fluctuation in the value of our derivatives, but instead priced the overall transaction to take this risk into account. This structure gives us certainty that we never have to post cash margin while the derivatives are outstanding.

However, last month U.S. regulators proposed that they, not end-users and their counterparties, will have the final say over how much cash an end-user will have to divert to a margin account where we are concerned it will sit idle, unavailable for productive uses. In our world of finite limits and financial constraints, posting a fluctuating cash margin would be a direct, dollar for dollar subtraction from funds that we would otherwise use to expand our plants, build inventory to support higher sales, conduct research and development, and ultimately grow jobs and sustain our international competitiveness.

In the Brazilian soybean market, we compete against international producers based in Germany, Switzerland, Australia, as well as local Brazilian companies. Because of significant differences in the way derivatives regulation is being implemented in Europe and elsewhere outside the United States, FMC and other U.S. companies could be put at a competitive disadvantage. Our foreign competitors in the Brazilian markets will not be subject to margining by their regulators as we now understand the rules.

International derivatives regulation as we heard from Commissioner Sommers is on a much slower track than we are moving in the United States. Unfortunately for American business, we will be at a relative competitive disadvantage until such time in the future when and if those rules might converge. We will also bear higher absolute costs than we did before the new rules and will be subject to the risk of regulatory arbitrage. Competitors in countries that are not pursuing so stringent a new regulatory framework for end-users will have that advantage.

Although I have focused here on international competitiveness and margin, end-users are concerned about the more than 100 new rules, how they will operate when taken together, whether we can continue to manage our business risks through derivatives. I noted some of these concerns in my written testimony and I am happy to discuss them during questioning. Thank you again for your attention to our concerns.

[The prepared statement of Mr. Deas follows:]

PREPARED STATEMENT OF THOMAS C. DEAS, JR., VICE PRESIDENT AND TREASURER, FMC CORPORATION; PRESIDENT, NATIONAL ASSOCIATION OF CORPORATE TREASURERS, PHILADELPHIA, PA

Good morning, I am Tom Deas, Vice President and Treasurer of FMC Corporation and also President of the National Association of Corporate Treasurers ("NACT"), an organization of treasury professionals from several hundred of the largest public and private companies in the country. FMC, NACT, and another organization of which FMC is also a member, the Agricultural Retailers Association, are part of the Coalition for Derivatives End-Users (the "Coalition"). Our Coalition represents thousands of companies across the United States that employ derivatives to manage business risks they face every day. Thank you very much for giving me the opportunity to speak with you today about derivatives regulation.

I am particularly gratified to appear before this Committee because support of American agriculture was the very reason for my company's founding almost 130 years ago. FMC Corporation began operations in the 1880s as a manufacturer of agricultural spray equipment to aid farmers combating infestations in their fields and orchards. Today in addition to making agricultural chemicals farmers apply to protect their crops, our 5,000 employees work hard to ensure that FMC continues to be a world-leading manufacturer and marketer of agricultural, specialty and industrial chemicals.

Along with many other U.S. manufacturers and agricultural producers, FMC uses over-the-counter ("OTC") derivatives to hedge business risks in a cost-effective way. We are very concerned that several of the proposed derivatives regulations and the aggressive schedule for rulemaking could hamper our use of this important tool and adversely affect our global competitiveness. I had the valuable experience of negotiating and executing some of the very first OTC derivatives—currency swaps—back in 1984. The OTC derivatives market has grown from its inception at that time to its current size by offering end-users a degree of customization not available in exchange-traded derivatives. FMC and other end-users enter into OTC derivatives customized to match the amount, timing, and where necessary, the currency, of their underlying business exposures. By matching derivatives to our business exposures, we create an effective economic hedge. The value of the derivative moves in an equal, but opposite, way in relation to the value of the underlying risk we are hedging. Let me give you a specific example of how proposed derivatives regulation could hamper my company's ability to compete against foreign producers.

FMC competes very effectively against foreign companies in several markets for our crop protection chemicals. For example in Brazil, we have leading positions in sugarcane and cotton. To enhance our product offering to Brazilian soybean farmers and profitably grow our business there, we offer to sell our agricultural chemicals for use at planting time in exchange for an agreed quantity of soybeans at harvest time. We can do this because we simultaneously enter into a custom OTC derivative that offsets the amount and timing of the future delivery of soybeans by our customers. In a developing economy like Brazil, farmers do not have FMC's degree of access to the worldwide financial markets. We provide our products to Brazilian farmers on terms that insulate them from the risk of changes in future commodity prices and foreign exchange movements in the price of the Brazilian real against the U.S. dollar. In the Brazilian soybean market, we compete against international producers based in Germany, Switzerland, and Australia, as well as local Brazilian companies. Because of significant differences in the way derivatives regulation is being implemented in Europe and elsewhere outside the United States, FMC and other U.S. companies could be put at a competitive disadvantage. Our competitors in the Brazilian market will not be subject to margining by EU, Swiss, Australian, or Brazilian regulators. We understand EU regulation is moving toward legislative enactment sometime this autumn with regulations not fully effective before the end of 2012. Few of our large developing-economy trading partners, Brazil included, have announced any plans for local derivatives regulation.

In January I met with economic development authorities in Singapore. I can tell you that they are making a vigorous effort to attract treasury centers from multinational corporations through targeted incentives and a predictable regulatory framework. They do not propose to require cash margining of derivative positions for companies operating there.

Competitive Consequences of End-User Margining

At the time of passage of the Dodd-Frank Act, we understood from the legislative language as well as from letters and colloquies by the principal drafters, that end-users would be exempted from any requirement to post cash margin. However, rules proposed last month would give the prudential regulators the authority to impose a framework with many complicated parameters, each of which is subject to future adjustment, which could result in many end-users—regardless of their size—having to post cash margin for their derivatives transactions. This proposal and the uncertainties it creates represent a real challenge to making business decisions about the future. As previously mentioned, the European Union regulators have taken a much slower track to derivatives regulation, but we know their approach thus far with regard to non-financial end-users is to provide them with a clear exemption from margining. They have accepted the argument that end-users, whose derivatives activity comprises less than ten percent of the total OTC derivatives market, are not significantly contributing to systemic risk and should be exempt from regulations designed for swap dealers. At this point, just weeks away from the mid-July implementation deadline, U.S. end-users still do not know with certainty what their future cash margin requirements will be. The U.S. regulators have taken a pair of offsetting transactions that match completely, and settle with offsetting cash payments at maturity, as does FMC's soybean sale and hedge, and created a new and unwelcome uncertainty—that of funding a daily fluctuating cash margin call. While this may be appropriate for swap dealers making a market in derivatives or those using derivatives for speculative purposes, its application to end-users hedging underlying business exposures creates an imbalance that is economically burdensome to end-users. We have been encouraged by comments of regulators signaling they may phase implementation over an extended period. We believe it essential that such phasing account for the limited resources end-users have to comply with new requirements. We also believe it essential that regulators clearly communicate the implementation schedule so that market participants can have certainty as to the timing of new requirements.

I had the privilege of representing the United States at the most recent meeting of the International Group of Treasury Associations. I can tell you that treasurers from more than thirty other countries from all over the world were sympathetic that we, not they, would be the first to implement derivatives regulations. Their expectation was that for a market so large and complex there would be many areas that would have to be adjusted based on U.S. experience. Unfortunately for American business, we will be at a relative competitive disadvantage until such time in the future when the rules might converge. We will also bear higher absolute costs than we did before the new rules and will also be subject to the risk of regulatory arbitrage from competitors in countries not pursuing a stringent new regulatory framework for end-users.

Cost of End-User Margining

FMC's derivatives are executed with several banks, all of which are also supporting our company through their provision of credit lines. None of these banks require FMC to post any form of collateral to secure their credit support. Our banks also do not require FMC to post cash margin as collateral to secure mark-to-market fluctuations in the value of derivatives. Instead they price the overall transactions to take this risk into account. This structure gives us certainty so that we never have to post cash margin while the derivative is outstanding. However, if we are required by the regulators to post margin, we will have to hold aside cash and readily available credit to meet those margin calls.

Depending on the extent of price movements, margin might have to be posted within the trading day as well as at the close of trading. Because failure to meet a margin call would be like bouncing a check, and would constitute a default, our corporate treasury would act very conservatively in holding cash or immediately available funds under our bank lines of credit to assure we could meet any future margin call in a timely fashion and with a comfortable cushion.

Adopting more conservative cash management practices might sound like an appropriate response in the wake of the financial crisis. However, end-users did not cause the financial crisis. End-users do not contribute meaningfully to systemic risk because their use of derivatives constitutes prudent, risk mitigating hedging of their underlying business. Forcing end-users to put up cash for fluctuating derivatives valuations means less funding is available to grow their businesses and expand employment. The reality treasurers face is that the money to margin derivatives has to come from somewhere and inevitably less funding will be available to operate their businesses.

FMC and other members of the Business Roundtable estimated that BRT-member companies would have to hold aside on average $269 million of cash or immediately available bank credit to meet a three percent initial margin requirement. Though the rule proposed by regulators is not specific as to the precise amount of collateral, in our world of finite limits and financial constraints, any cash margin requirements represent a direct dollar-for-dollar subtraction from funds that we would otherwise use to expand our plants, build inventory to support higher sales, undertake research and development activities, and ultimately sustain and grow jobs. In fact, the study extrapolated the effects across the S&P 500, of which FMC is also a member, to predict the consequent loss of 100,000 to 120,000 jobs. The effect on the many thousands of end-users beyond the S&P 500 would be proportionately greater. We would also have to make a considerable investment in information systems that would replicate much of the technology in a bank's trading room for marking to market and settling derivatives transactions.

Exemption from Margining for Foreign Exchange Transactions

End-users welcomed the determination last month by the Secretary of the Treasury that most foreign exchange ("FX") forward transactions would not be considered derivatives subject to regulation under Title VII of the Dodd-Frank Act. However a common type foreign exchange hedge, technically known as a "non-deliverable forward" was not included in this exemption. This type of transaction is typically used to hedge currencies that are not freely traded such as the currencies of Brazil, China, India and those of other rapidly developing economies that have imposed exchange controls. It is used in the same way as those FX forwards that were exempted.

The cumulative effect of these regulations could mean that U.S.-based exporters would be subject to higher risks based on an inability to hedge efficiently their foreign exchange risk with derivatives. As a result they could be forced to move production offshore to match their costs directly with the currencies of their customers.

Summary of End-User Concerns

Let me take a moment to summarize some of our principal concerns with the implementation of derivatives regulation:

- First, we are concerned that the regulations have *imposed an uncertain framework for cash margin on end-user trades,* potentially diverting billions of dollars from productive investment and employment into an idle regulatory levy.
- Second, even if the final regulations clearly exempt end-users from margin requirements, we still have the risk that the regulators will *require swap dealers to hold excessive capital in reserve against uncleared over-the-counter derivatives—with the cost passed on to end-users* as they manage their business risks. We believe that swap dealers' capital requirements should be appropriate to the actual loss experience of the specific type of derivative. The unintended consequence of punitive capital requirements could be for some end-users to cease hedging risks and for others to use foreign markets.
- Finally, we are concerned that regulators will make customized derivatives prohibitively expensive through margin and increased capital requirements, with the effect of *forcing us into standardized derivatives from common trading facilities* that will not provide the exact match we seek with our underlying business exposures. It is the customization available with OTC derivatives that is so valuable to us and makes the derivatives effective in hedging our exposures.

I know many people who suffered through the financial turmoil of 2008 are tempted to label all derivatives as risky bets that should be curtailed. However, I hope these examples of prudent use of derivatives by my company and other end-users who form the backbone of our country's economy have demonstrated the wisdom of the end-user exemptions that we believe to have been the legislative intent.

I will note that in general those charged with the responsibility of drafting derivatives regulations have been very forthcoming and open in soliciting input from end-users. We appreciate being involved, but we have only weeks until the deadline for finalizing these rules. The end-user exemption we thought was clear is now uncertain and several important rules required by July have not been finalized. Inadequate time has been allowed for us to understand and comment on how the rules will operate together. We support fully efforts to extend the statutory date by which rules must be promulgated until the remaining uncertainties can be clarified and we can be assured the rules will operate effectively in this very complicated cross-border market. We also support legislation to create a true exemption from margin requirements that would apply to all end-users. The consequences of getting derivatives regulation wrong will be borne by American business and ultimately our fellow citizens.

Thank you for your time. I would be happy to respond to any questions you may have.

Mr. NEUGEBAUER. Thank you, Mr. Deas. And now Ms. Miller.

STATEMENT OF SARAH A. "SALLY" MILLER, CHIEF EXECUTIVE OFFICER, INSTITUTE OF INTERNATIONAL BANKERS, NEW YORK, NY

Ms. MILLER. Mr. Chairman, Members of the Subcommittee, my name is Sally Miller and I am the Chief Executive Officer of the Institute of International Bankers. I am pleased to be here today to testify on Title VII of Dodd-Frank and the need to harmonize global derivatives reform.

The Institute represents internationally headquartered financial institutions from over 35 countries. Our members include international banks that operate branches and agencies and bank and broker-dealer subsidiaries in the United States. Our members have more than $4.5 trillion of total assets in the U.S. They employ more than 250,000 U.S. citizens and permanent residents. Our members also include eight of the 14 largest international derivatives dealers. Our members support Title VII's objectives of reducing systemic risk and increasing transparency. Together, we have developed a proposal on the cross-border application of Title VII. Our members are not looking for a free pass. We are not seeking a competitive advantage over U.S. firms. Instead, we have sought to assist global regulators to develop a workable regime for supervising U.S. and foreign firms that operate global swap businesses.

Before I get into the details of our proposal, it is important to note that foreign and U.S. firms alike seek to minimize the number of legal entities through which they conduct swap dealing activities. This increases efficiency and decreases risk by permitting the dealer and its counterparties to net and offset their exposures.

It also allows counterparties to transact with a more creditworthy entity and for foreign firms that entity is usually located and supervised outside of the U.S. U.S.-based personnel may however have relationships with U.S. customers. Our proposal would apply the following four principles.

First, we are not asking for an exemption from swap dealer registration. Anytime that swap dealing activities occurs directly with U.S. customers or from within the U.S., a U.S.-registered swap dealer would be involved.

Second, U.S. clearing trading, reporting, business conduct, and similar requirements should apply to transactions with U.S. persons or to transactions that are entered into from the United States. All transactions with foreign persons entered into abroad, however, should be subject to the relevant foreign rules rather than U.S. rules.

Three, where they determine it to be comparable, U.S. regulators should leverage effective foreign supervision of foreign firms, capital and other entity-wide requirements. U.S. regulators would still retain their full enforcement authority.

And four, foreign regulators should be encouraged to adopt comparable regulations and open access further to U.S. firms. In particular, we want to encourage the EU's recent proposal for recognizing the equivalent third country regimes. We believe that these principles will maintain the liquidity of the U.S. derivatives market and the preeminence of the U.S. as a leading international financial center. These principles would also allow U.S. and foreign dealers to access U.S. and foreign markets on the same terms without imposing an artificial business structure.

If U.S. regulators were to require foreign dealers to conduct their U.S. swap activities through separate U.S. subsidiaries, U.S. customers and foreign dealers would face additional costs. The significant negative impacts on capital, netting, and risk management resulting from trading swaps through multiple U.S. and non-U.S. legal entities could also reduce U.S. market liquidity.

I would also like to take this opportunity to discuss briefly Section 716 or the Swaps Push Out Provision. Section 716's exceptions for FDIC insured banks do not extend to uninsured U.S. branches or agencies of foreign banks. When Dodd-Frank was enacted Members of Congress recognized that this oversight was unintentional. Left uncorrected, this error will conflict with the U.S. policy of providing parity of treatment between foreign and U.S. banks.

This is because Section 716 will prevent foreign banks from conducting bank permissible businesses and managing their risk through U.S. branches. It will also cause serious disruptions as foreign banks are forced to move possibly off shore, entire portfolios currently booked in their U.S. branches. We strongly support extending 716's exception to U.S. branches and agencies of foreign banks. However, we recognize that this would be an imperfect solution.

It would still require some swap activities to be pushed out of both U.S. and foreign banks and accordingly we would support further efforts to prevent the adverse impacts on capital, netting, and risk management that will otherwise result from forcing swap activities to be conducted across multiple legal entities. Thank you for the opportunity to appear here before you today. I would be happy to answer any questions you might have.

[The prepared statement of Ms. Miller follows:]

PREPARED STATEMENT OF SARAH A. "SALLY" MILLER, CHIEF EXECUTIVE OFFICER, INSTITUTE OF INTERNATIONAL BANKERS, NEW YORK, NY

Chairman Conaway, Ranking Member Boswell, Members of the Subcommittee:

My name is Sally Miller and I am the Chief Executive Officer of the Institute of International Bankers. I am pleased to be here today to testify on Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the need to harmonize global derivatives reform. The Institute and its members support Dodd-Frank's objectives of reducing systemic risk and increasing transparency in the OTC derivatives markets. We also support the commitments of the G20 leaders to setting high, internationally consistent requirements for OTC derivatives and avoiding overlapping regulations.

Consistent with these principles, we have worked with our members to develop a proposal on the cross-border application of Title VII. Our goals are four-fold; to be (1) faithful to the statute, (2) protective of U.S. customers, (3) sensitive to the challenges faced by regulators in supervising foreign entities and activities, and (4) supportive of international harmonization.

We believe that, under our proposal, Title VII can be applied fairly to all derivatives dealers in a way that does not cause undue disruption and increased costs to customers and the overall financial system.

Background

Before describing our proposal in more detail, I would like to provide some background on the Institute and our members. The Institute represents the interests of internationally headquartered financial institutions from over 35 countries. Our members include international banks that operate branches and agencies and bank and broker-dealer subsidiaries in the United States.

Our members play an important role in the U.S. economy and its markets:

- The U.S. operations of our members have more than $4.5 trillion in total assets;
- Our members employ more than 250,000 U.S. citizens and permanent residents;
- Our members include eight of the 14 largest international derivatives dealers; and
- Many of our members use derivatives extensively in connection with their U.S. lending activities.

As a general matter, the international framework for the supervision of cross-border banking activities is based on considerations of comity and appropriate allocation of supervisory responsibilities across home and host country supervisors. As applied in the United States, this framework is reflected in the longstanding policy of national treatment, *i.e.,* there should be parity of treatment between U.S. banks and international banking firms that operate in the United States, and the understanding that international banking firms are subject to primary supervision by their home country authorities with U.S. authorities, primarily the Federal Reserve Board, as host country supervisors, exercising appropriate oversight of international banking firms' U.S. operations. Accordingly, the U.S. banking and non-banking operations of our members, like their U.S. counterparts, are subject to extensive U.S. regulation and supervision by the Federal banking agencies, the Securities and Exchange Commission and the Commodity Futures Trading Commission, as appropriate.

Swap Dealer Registration and Regulation

Foreign banks and U.S. banks alike seek to minimize the number of legal entities through which they conduct swap dealing activities and, where possible, to use a single legal entity to transact with swap counterparties globally. This increases efficiency and decreases risk by permitting the bank and its counterparties to net and offset their exposures. It also allows counterparties to transact with a more credit-worthy entity, which for foreign banks is usually located and supervised outside the U.S. The personnel who have relationships with U.S. customers or manage U.S.-related portfolios on behalf of their head office are often, however, located inside the U.S.

Our proposal, which would apply Title VII to this and other common ways in which international derivatives dealers operate, has been guided by the following considerations:

(1) We have sought to be faithful to the statute; we are not asking for an exemption from swap dealer registration. Any time that swap dealing activities occur directly with U.S. customers or from within the U.S., a U.S.-registered swap dealer would be involved. Additionally, the personnel interacting with U.S. customers would be employed by a U.S. registrant subject to supervision and examination by the CFTC and the SEC.

(2) We have sought to protect U.S. customers. Under our proposal, U.S. regulations that apply to particular transactions, such as customer business conduct standards, would apply to transactions entered into with a U.S. counterparty or from within the U.S. Transactions entered into with foreign counterparties from abroad would, of course, be subject to the rules of the relevant foreign jurisdictions, rather than U.S. rules.

(3) We have sought to be sensitive to the resource constraints of U.S. regulators. Under our proposal, U.S. regulators could leverage effective foreign supervision while retaining their full enforcement authority. So, if U.S. regulators determine that home country capital and other similar entity-wide regulations are sufficiently comparable to U.S. regulations, then compliance with those regulations would constitute compliance with U.S. requirements, and failure to comply would be treated as noncompliance with U.S. requirements enforceable by U.S.

regulators. This is consistent with the Federal Reserve Board's current proposal for swap dealer capital requirements.

(4) We have sought to support and encourage international harmonization. We believe that our proposal would encourage foreign regulators to adopt regulations comparable to the U.S. and to open access further to U.S. banks. In particular, we believe it would be consistent with the approach of recognizing equivalent third country regimes that is currently under consideration by the EU.

We believe that this proposal will help maintain the preeminence of the U.S. as a leading international financial center by maintaining the liquidity of the U.S. derivatives market. By contrast, if Title VII were to effectively require foreign banks to conduct their derivatives dealing activities in the U.S. through separately incorporated subsidiaries, U.S. customers and foreign banks would face inefficiencies and additional costs of transacting in derivatives through multiple legal entities. The significant negative impacts on capital, netting and risk management resulting from conducting derivatives trading through multiple U.S. and non-U.S. legal entities could also reduce the liquidity available to U.S. market participants.

Swaps Push-Out and Swap Dealer Definition

I would also like to discuss two other provisions of Title VII, specifically Section 716 of Dodd-Frank, also known as the "swaps push-out" provision, and the definition of "swap dealer" under Section 1(a)(49) of the Commodity Exchange Act. Although Section 716 contains exceptions for FDIC-insured banks, those exceptions do not extend to uninsured U.S. branches or agencies of foreign banks. When Dodd-Frank was enacted, Members of Congress recognized that this oversight was unintentional. Left uncorrected, it will, contrary to U.S. policy, prevent foreign banks from conducting bank-permissible businesses and managing risks through their U.S. branches. It also will cause serious market and business disruptions as foreign banks are forced to assign and re-document entire portfolios booked in their U.S. branches.

While we strongly support extending Section 716's exceptions to U.S. branches and agencies, we recognize, however, that this would be an imperfect solution, since it would still require some swap activities to be "pushed-out" of both domestic and international banking entities. Accordingly, we would support further efforts to prevent the adverse impacts on capital, netting and risk management that will otherwise result from forcing derivatives activities to be conducted across multiple legal entities.

Finally, we would support revisions to the definition of "swap dealer" that would allow branches and agencies of international banks, like FDIC-insured depository institutions, to enter into swaps with customers as an adjunct to their loan origination activities without having to register as a swap dealer. Branches and agencies of international banks are significant credit providers in this country. Indeed, the U.S. operations of international banks account for approximately 25% of all U.S. commercial and industrial loans. To permit these institutions to enter into swaps with their customers only as a registered dealer puts foreign banking institutions at a competitive disadvantage to U.S. firms and, more importantly, could discourage further lending in this country by foreign banking institutions.

In conclusion, we believe that the U.S. branches and agencies of foreign banks should be treated the same as U.S. banks with respect to the swap push-out safe harbor and the "loan origination" exclusion from the definition of "swap dealer". More generally, and of equal importance, we believe that our proposed framework will assist global regulators to develop a rational and workable supervisory regime for those U.S. and foreign banking operations that operate global swap businesses.

Thank you for the opportunity to appear before you today. I would be happy to answer any questions you might have.

ATTACHMENTS

January 10, 2011

ELIZABETH M. MURPHY,
Secretary,
Securities and Exchange Commission,
Washington, D.C.;

DAVID A. STAWICK
Secretary,
Commodity Futures Trading Commission,
Washington, D.C.

Re: Registration of Swap Dealers and Major Swap Participants, RIN 3038–AC95;[1] *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant," RIN 3235–AK65.*[2]

Secretary Murphy, Secretary Stawick:

The Institute of International Bankers (the "*Institute*") appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "*SEC*") and the Commodity Futures Trading Commission (the "*CFTC*" and, together with the SEC, the "*Commissions*") with respect to the Proposed Rules. The Institute and its members support the efforts of the Commissions and their counterparts in other jurisdictions to enhance the resiliency of the financial system, reduce systemic risk and increase transparency in the OTC derivatives markets. Given the truly global nature of the OTC derivatives markets, the Institute believes that, to accomplish these objectives, the Commissions must establish, in the near-term, an appropriate framework for U.S. regulation of the cross-border swap activities of foreign banks.[3]

While such a framework must of course be consistent with the Commissions' statutory mandates under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*") and appropriately protective of U.S. markets and customers, the Institute emphasizes that it must also take into account the various ways in which cross-border swap activities are conducted, inherent limitations on the Commissions' ability to effectively oversee extraterritorial activities, and the legitimate interests of regulators outside the U.S. in discharging their responsibilities as the primary supervisors of foreign banks.

In light of these considerations, the Institute respectfully proposes to the Commissions below a framework for global supervision of cross-border swap activity by foreign banks. The proposed framework is designed to (i) allocate to the Commissions the regulation of swap activity conducted with U.S. counterparties, (ii) allocate to home (or non-U.S. host) country authorities the regulation of swap activity conducted with counterparties located outside the U.S., and (iii) establish an appropriate allocation of regulatory responsibilities for registration, transaction-specific and non-transaction-specific supervision. In recognition of the structural diversity of the swap markets, this letter provides an overview of how this framework would be applied to a variety of common transaction paradigms.

The Institute believes that this proposed framework is best-suited to accomplishing Dodd-Frank's objectives while minimizing the potential for overlapping and inconsistent requirements. As a result, this framework would reinforce continued cross-border regulatory cooperation, promote efficient use of supervisory resources, prevent fragmentation of the derivatives markets along regional lines, and avoid the concomitant adverse consequences for systemic risk, transparency and economic efficiency. We believe that the proposed framework is consistent with the purposes of Dodd-Frank and within the scope of the Commissions' interpretive and definitional authority thereunder.

Summary

Sections 731 and 764 of Dodd-Frank require swap and security-based swap dealers (collectively, "*Swap Dealers*") and major swap and security-based swap participants (collectively, "*MSPs*") to register with the CFTC and the SEC. Sections 721 and 761 of Dodd-Frank generally define a Swap Dealer as any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account, or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. Sections 721 and 761 generally define MSPs, in turn, to include persons whose swap positions exceed thresholds established for the "effective monitoring, management, and oversight of entities that are systemically significant or can significantly impact the financial system of the *United States*" or whose "outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the *United States* banking system or financial markets" (emphases added).

Section 712(d) directs the Commissions, in consultation with the Board of Governors of the Federal Reserve System (the "*Board*"), to further define Swap Dealer and MSP. Section 712(d) also provides the Commissions with broad, flexible authority to adopt such other rules regarding the Swap Dealer and MSP definitions as the

[1] 75 *Fed. Reg.* 71379 (Nov. 23, 2010) (the "*CFTC Registration Proposal*").
[2] 75 *Fed. Reg.* 80174 (Dec. 21, 2010) (the "*Joint Definitions Proposal*" and, together with the CFTC Registration Proposal, the "*Proposed Rules*").
[3] For convenience, unless otherwise specified, references in this letter to "swaps" are intended to refer to both swaps and security-based swaps.

Commissions determine are necessary and appropriate, in the public interest, and for the protection of investors.

Sections 722 and 772 of Dodd-Frank, in turn, establish the territorial scope of each Commission's jurisdiction with respect to swap activities. For the CFTC, Section 722 provides that the provisions of the Commodity Exchange Act ("*CEA*") relating to swaps that were enacted by Title VII of Dodd-Frank "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 [or] contravene [CFTC anti-evasion rules]." For the SEC, Section 772 provides that "[n]o provision" of the Securities Exchange Act of 1934 (the "*Exchange Act*") added by Title VII of Dodd-Frank "shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of [SEC anti-evasion rules]." These provisions are consistent with existing interpretations and statutory provisions setting forth each of the Commissions' jurisdictions.[4]

Congress also recognized the Board's expertise in supervising the cross-border banking operations of foreign banks when it designated the Board, in Section 721's "prudential regulator" definition and the capital and margin provisions of Sections 731 and 764, as the prudential regulator of Swap Dealers and MSPs that are state-licensed branches and agencies of foreign banks, foreign banks that do not operate insured branches, and foreign banks that are, or are treated as, bank holding companies under the International Banking Act of 1978.[5]

As a general matter, the international framework for the supervision of cross-border banking activities is premised on an allocation of supervisory responsibilities across home and host country supervisors. The Board's own framework for supervising the cross-border banking operations of a foreign bank is based on an understanding that the foreign bank is subject to primary supervision by its home country authority, with the Board, as a host country supervisor, exercising appropriate oversight of the bank's U.S. operations.[6]

As part of this framework, the Board assesses a foreign bank's capital adequacy in approving applications by the bank to establish a U.S. branch or agency or to make a bank or non-bank acquisition in the United States.[7] Such assessments require a determination regarding whether the foreign bank's capital is equivalent to the capital that would be required of a similarly situated U.S. banking organization.[8] Similarly, the Board assesses a foreign bank's capital in connection with a declaration by the bank to become a financial holding company ("FHC"), which requires that the foreign bank be "well-capitalized." For these purposes, the Board's assessment is based on whether the foreign bank's capital is comparable to the capital required in the case of a similarly situated U.S. banking organization seeking FHC status, "giving due regard to the principle of national treatment and equality of competitive opportunity."[9] In the case of a foreign bank whose home country supervisor has adopted capital standards that are consistent with the Capital Accord of the Basel Committee on Banking Supervision, these various determinations are

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[4] *See, e.g.,* Statement of Policy Regarding Exercise of [CFTC] Jurisdiction Over Reparation Claims that Involve Extraterritorial Activities by Respondents, 49 *Fed. Reg.* 14721 (Apr. 13, 1984) (whether a person is required to be registered under the CEA may be determined by reference to whether (i) the person is based in the U.S., (ii) the person engages in the prescribed activities with customers in the U.S. or (iii) the prescribed activities take place or originate in the U.S.); *In the Matter of Sumitomo Corporation,* Comm. Fut. L. Rep. ¶27, 327 (May 11, 1998) (CFTC enforcement action for manipulative copper trading outside the U.S. that directly affected U.S. prices); Exchange Act Section 30(b) (providing that the Exchange Act "shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States").

[5] Section 721 similarly designates the Office of the Comptroller of the Currency (the "*OCC*") as the prudential regulator of Swap Dealers and MSPs that are federally-licensed branches and agencies of foreign banks. Notably, in exercising supervisory authority over Federal branches and agencies in matters relating to capital, the OCC looks to the capital of the foreign bank itself. *See* 12 CFR § 28.14(a).

[6] *See* Federal Reserve Board, "Policy Statement on the Supervision and Regulation of Foreign Banking Organizations" (Feb 23, 1979), Federal Reserve Regulatory Service 4–835; Federal Reserve Board Supervisory Letter SR 08–09 *re* Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008).

[7] *See* 12 U.S.C. §§ 1842(c), 1843(j) and 3105(d)(3)(B) and (j)(2).

[8] In the case of branches and agencies, the capital adequacy determination is made by reference to the capital of the foreign bank since a branch or agency does not have any capital itself. *See, e.g.,,* 12 CFR § 225.2(r)(3)(ii).

[9] *See* 12 U.S.C. § 1843(l)(3).

made on the basis of the bank's capital ratios calculated in accordance with applicable home country standards.[10]

As a result, as the Board is vested with, and will retain, authority to set and enforce capital and margin standards for foreign banks and state-licensed U.S. branches and agencies that register as Swap Dealers, it would be consistent with the Board's long-standing approach to cross-border banking supervision for it to give appropriate deference to home country supervisors with respect to capital and margin oversight in those cases where the Board has determined, or in the future determines, that the relevant supervisory regime is consistent with the standards required under Dodd-Frank.[11] This approach is also consistent with the international harmonization provisions contained in Section 752 of Dodd-Frank.

Further, the Swap Dealer/MSP provisions of Dodd-Frank must be interpreted in light of generally applicable principles of statutory construction. In particular, as reaffirmed by the Supreme Court in its recent *Morrison* v. *National Australia Bank* decision, it is a "long-standing principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[12] The presence of the territorial limitations in Sections 722 and 772 should not be regarded as indicating a contrary Congressional intent to apply Title VII of Dodd-Frank extraterritorially, except in the limited circumstances expressly addressed by Sections 722 and 772.[13] This is especially the case given that, under principles of statutory construction, Congress is deemed to have been on notice of the *Morrison* decision when it enacted Dodd-Frank and Congress chose to enact language in Section 772 that is modeled on the language in Section 30(b) of the Exchange Act interpreted by the Court in *Morrison.*

Moreover, as the CFTC has noted, even where the Commissions may have jurisdiction, considerations of international comity should play an important role in determining the appropriate scope for the Commissions' oversight of extraterritorial activities under Federal statutes.[14] In the particular context of Title VII of Dodd-Frank, the Commissions must take into account the nature and structuring of the interactions between swap counterparties located within and outside the U.S., the extent to which other regulatory regimes substantially parallel U.S. law, and the extent to which non-U.S. regulators are better positioned to effectively supervise the activities conducted, and the institutions domiciled, in their jurisdictions.[15]

These legal considerations underscore the very real practical considerations that the Commissions must address. Globally, there are a number of paradigms under

[10] *See, e.g.,* 12 CFR §§ 225.2(r)(3)(i)(A) (bank and non-bank acquisitions) and 225.90(b)(1) (FHC declarations). In considering whether a foreign bank that seeks to become an FHC is well-capitalized in accordance with comparable capital adequacy standards, the Board also considers the foreign bank's composition of capital, Tier 1 leverage ratio, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements, anti-money laundering procedures, and whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country authorities. *See* 12 CFR § 225.92(e)(1).

[11] Sections 731 and 764 of Dodd-Frank require the Board's capital requirements for Swap Dealers and MSPs to ensure the safety and soundness of the Swap Dealer or MSP and be appropriate for the risk associated with the noncleared swaps held by the Swap Dealer or MSP. In the Institute's view, home country capital requirements deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision would clearly satisfy these standards, especially as deference to those requirements would facilitate consolidated supervision by home country authorities. For similar reasons, the Institute also views this approach as warranted for non-U.S. entities for which the Commissions are responsible for setting capital and margin requirements, such as foreign broker-dealers and investment firms that are also subject to comparable requirements supervised by home country authorities. Such an approach would help to ensure that the Commissions and the prudential regulators establish and maintain comparable capital and margin requirements, as required by Sections 731 and 764 of Dodd-Frank.

[12] 130 S. Ct. 2869 (2010) at 2877. Notably, in applying *Morrison* in the context of security-based swaps to hold that the Federal securities laws do not permit recovery of losses from swap agreements that reference securities traded on a foreign exchange, the U.S. District Court for the Southern District of New York recently emphasized "*Morrison*'s strong pronouncement that U.S. courts ought not to interfere with foreign securities regulation without a clear Congressional mandate." *Elliot Associates, L.P.* v. *Porsche Automobil Holding SE,* No. 10 Civ. 532 (HB) (S.D.N.Y. Dec. 30, 2010) at 13. The Institute urges the Commissions to apply the same principle to Title VII, *i.e.,* to avoid applying the normative regulatory provisions of Title VII in a manner that would unduly interfere with the regulation of foreign banks by their home country authorities.

[13] *See id.* at 2882–83 (applying the same analysis to the analogous language in Section 30(b) of the Exchange Act).

[14] CFTC Registration Proposal at 71382 (citing *Hartford Fire Insurance Co.* v. *California,* 509 U.S. 764 (1993)).

[15] *See* 1 Restatement (Third) of Foreign Relations Law of the United States §§ 402–403 (1987), cited in CFTC Registration Proposal at 71382.

which swap activity is conducted. To achieve the benefits of reduced risk and increased liquidity and efficiency associated with netting and margining on a portfolio basis, foreign banks (like their U.S. domestic counterparts) typically seek to transact with swap counterparties globally, to the extent feasible, through a single, highly creditworthy entity. In many cases, however, the personnel who have relationships with U.S. customers or who manage the market risk of the foreign bank's swap portfolio are located regionally, outside the jurisdiction in which the foreign bank is domiciled. In some cases, entities other than the foreign bank (such as a U.S. branch, agency, or affiliate) transact with local customers in order to satisfy unique customer documentation, insolvency, tax, regulatory, or other considerations.

Additionally, the swap and other activities of most foreign banks are already subject to comprehensive prudential supervision and regulation by home country authorities, who, of necessity, serve as the primary supervisors of those activities. Authorities in those jurisdictions likewise also often permit U.S. banks to deal in derivatives with institutional customers in those jurisdictions without becoming subject to host country licensing or registration requirements.[16] The European Commission ("EC") has proposed for comment and is in the process of considering revisions to the Markets in Financial Instruments Directive (among others) that would allow it to negotiate mutual recognition frameworks with non-EU countries that would result in "exemptive relief for investment firms and market operators based in jurisdictions with equivalent regulatory regimes applicable to markets in financial instruments."[17] The Institute strongly urges the Commissions to work cooperatively with authorities in the EU and other jurisdictions, consistent with the principles articulated by the G20,[18] in implementing frameworks for cross-border access, based on home country supervision that is determined to be equivalent to that of the host jurisdiction(s).[19]

Accordingly, the Commissions should establish a framework for cross-border swap activities that preserves and leverages the strengths of existing market practices and home country supervision and regulation. Such a framework would have the salutary benefits of facilitating cross-border liquidity and access of counterparties to both domestic and offshore markets. The Commission should likewise avoid a framework that is duplicative, inefficient (for supervisors and market participants) and would result in unrealistic extraterritorial supervisory responsibilities for the Commissions and potential fragmentation of the derivatives markets. In this regard, we note that any inefficiencies associated with an inappropriate U.S. framework are likely to be compounded to the extent that any such framework engenders reciprocal approaches abroad.

Specifically, the Institute respectfully recommends that the Commissions use the interpretive and definitional authority granted to them under Title VII of Dodd-Frank to provide certain clarifications discussed in **Part I** below regarding the nature of the connections to the U.S. that would require a non-U.S. person to register as a Swap Dealer or MSP. The Institute further recommends that the Commissions use that authority to establish a framework for Swap Dealer and MSP registration and regulation that addresses the following transaction paradigms:

(a) **Transactions Directly with a Foreign Bank.** As discussed in **Part II.A** below, a foreign bank that transacts in swaps in a dealing capacity directly (or through U.S. introducing brokers and/or broker-dealers) from abroad with U.S. customers without intermediation by a U.S.-registered Swap Dealer should be

[16] *See, e.g.,* FSA PERG 2.9.15–17 (overseas person exclusion).

[17] *Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID)* (Dec. 8, 2010) at Section 8.3 (Dec. 8, 2010), available at *http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf*. The EC also noted that it considers it necessary to establish an EU-wide regime for access by non-EU market participants to EU financial markets "in order to create a real level playing field for all financial services actors in the EU territory." *Id.*

[18] Consistent with declarations by the G20, both the proposed European Market Infrastructure Reform ("*EMIR*") and the amendment to Japan's Financial Instruments and Exchange Act enacted in May 2010 provide for mandatory clearing and enhanced public and regulatory transparency requirements for OTC derivatives. *See Derivatives Reform: Comparison of Title VII of the Dodd-Frank Act to International Legislation,* presentation prepared by the CFTC Staff for the Global Markets Advisory Committee (Oct. 5, 2010), available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/gmac_100510-cftc2.pdf*. A further proposed compromise version of EMIR was published by the Presidency of the Council of Ministers on December 7, 2010, and is available at *http://register.consilium.europa.eu/pdf/en/10/st17/st17615.en10.pdf*.

[19] To the extent that the Commissions believe that further legislative authorization would facilitate the implementation of such frameworks, the Institute strongly urges the Commissions to pursue such authorization.

subject to registration with the Commissions as a Swap Dealer, should be required to comply with Dodd-Frank's business conduct standards in connection with such activity, should be required to comply with home country capital and margin standards as deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision (as described above), and should otherwise be subject to home country standards and supervision;

(b) **Transactions Intermediated by a Registered U.S. Branch, Agency, or Affiliate.** As discussed in **Part II.B** below, a foreign bank subject to home country capital requirements deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision that transacts in swaps indirectly with U.S. customers through the intermediation of a U.S.-registered Swap Dealer acting as agent of the foreign bank should not itself be required to register as a Swap Dealer in the U.S. where the U.S.-registered Swap Dealer acting as agent takes responsibility for complying with Dodd-Frank's business conduct and other transaction-specific requirements as though it were the swap counterparty;

(c) **Transactions with a U.S. Branch, Agency, or Affiliate Acting as Principal in a Dealer Capacity.** As discussed in **Part II.C** below, a U.S. branch, agency, or affiliate of a foreign bank that, acting as a principal in a dealer capacity, transacts in swaps with counterparties located within and outside the U.S. should be required to register as a Swap Dealer in the U.S. and to comply with Dodd-Frank's business conduct and other regulatory standards (including capital and margin requirements as applied by the Board or the OCC, as applicable, in the case of a U.S. branch or agency)[20] in connection with all of its swap activity conducted from the U.S., but the foreign bank itself should not need to register and be subject to regulation as a Swap Dealer; and

(d) **Inter-Branch or Inter-affiliate Transactions.** As discussed in **Part II.D** below, swap transactions between a registered U.S. branch, agency, or affiliate and an unregistered foreign bank (or between a registered foreign bank and its unregistered U.S. branch, agency, or affiliate) conducted for the purpose of allocating market risk arising from swap dealing activities should not require the participating unregistered entity to register as a Swap Dealer or MSP, and such transactions should also not be subject to Dodd-Frank's mandatory clearing, execution, margin, or counterparty business conduct requirements.

Regardless of which of these transaction paradigms applies, this proposed regulatory framework would ensure that (i) the Board would be able to make a determination as to the comparability of the foreign bank's capital in accordance with its longstanding approach to cross-border banking supervision and, in appropriate circumstances, defer to home country capital requirements and prudential supervision and (ii) responsibility for compliance with Dodd-Frank's mandatory clearing, execution, counterparty business conduct, margin, segregation, and record-keeping requirements would lie with a Commission registrant.[21]

Discussion

I. Overall Scope of Swap Dealer and MSP Registration

In order to address the application of Swap Dealer or MSP registration and other requirements to particular transaction paradigms, the Commissions must first determine the nature of the connections to the U.S. that could require a non-U.S. person to register as a Swap Dealer or MSP.

[20] As discussed above in the text accompanying note 8, the capital of a U.S. branch or agency is assessed by reference to the capital of the foreign bank.

[21] In recommending this proposed framework, the Institute has sought to focus on certain core interpretive, definitional and other issues that arise in relation to cross-border swap activities. There are naturally other issues relating to the Swap Dealer and MSP definitions and other aspects of Dodd-Frank (including Section 716) that are relevant to internationally headquartered banks but are beyond the scope of this comment letter. For instance, the Institute urges the Commissions to apply the *de minimis* exception to the Swap Dealer definitions to foreign banks in a manner consistent with Sections 722 and 772 of Dodd-Frank, such as by excluding swaps with counterparties located outside the U.S. from the calculation of any relevant threshold based on size of positions or number of counterparties. The Institute also would like to call the CFTC's attention to the exclusion from the Swap Dealer definition for an insured depository institution that offers to enter into a swap with a customer in connection with originating a loan with that customer. Consistent with the longstanding U.S. principle of national treatment and equality of competitive opportunity with respect to foreign banks' U.S. operations, the CFTC should exercise its authority under Section 712(d) of Dodd-Frank to make that exclusion available to uninsured branches and agencies of foreign banks on the same terms that it is available to U.S. banks that are insured depository institutions.

In this regard, the Institute agrees with the CFTC that a person should not be required to register as a Swap Dealer if its only connection to the U.S. is the use of a U.S.-registered swap execution facility, derivatives clearing organization, or designated contract market in connection with its swap dealing activities, or its reporting of swaps to a U.S.-registered swap data repository.[22] The Institute urges the SEC to adopt a similar interpretation with respect to security-based swaps, consistent with its approach to foreign securities broker-dealers under the Exchange Act. The Institute similarly does not regard the reference to a U.S. underlier or reference entity in a swap conducted outside the U.S. by counterparties located outside the U.S. as a sufficient connection to the U.S. to subject either counterparty to U.S. Swap Dealer registration requirements, and we urge the Commissions to adopt such an interpretation.[23]

Similarly, neither the manner in which a swap is executed nor the underlier or reference obligation for the transaction should have any bearing on MSP registration, since neither factor is relevant to whether a non-U.S. person's swap activities give rise to the exceptional risks to the U.S. financial system that are the basis for MSP registration. Rather, the analysis of whether a non-U.S. person should register as an MSP should turn upon the scope and nature of its swap positions with unaffiliated U.S. counterparties (including U.S. clearinghouses, to the extent positions in cleared swaps are relevant to the determination of whether an entity is an MSP), and the related credit exposures to which they give rise.

Solicitation of or negotiation with counterparties located outside the U.S. by U.S.-based personnel employed by a separate U.S. branch, agency, or affiliate acting as agent for a non-U.S. person should also not subject a non-U.S. person to Swap Dealer registration. Dodd-Frank contemplates separate registration regimes, where appropriate, for persons who act in such an introducing capacity—introducing broker registration for swaps, and broker-dealer registration for security-based swaps. Similarly, swap portfolio management activities by a U.S. agent or U.S. advisor of a non-U.S. person are best addressed by requiring the agent or advisor, where appropriate, to register as either a commodity trading advisor (for swaps) or investment adviser (for security-based swaps), and should not subject the non-U.S. person to MSP registration unless the non-U.S. person's swaps are with unaffiliated U.S. counterparties (including U.S. clearinghouses, as noted above).[24]

It bears noting, in this regard, that different branches and agencies of a foreign bank should not be treated as the same legal "person" for purposes of Swap Dealer designation. As noted above, Dodd-Frank's "prudential regulator" definition distinguishes between a state or federally-licensed branch or agency of a foreign bank, on the one hand, and a foreign bank that does not operate an insured branch, on the other. These distinctions suggest that Congress intended to take an approach to Swap Dealer designation that is consistent with the traditional approach of Federal banking regulation, which likewise distinguishes between the U.S. branch or agency of a foreign bank and the foreign bank's branches and agencies outside the U.S.[25]

To the extent that a U.S. branch or agency of a foreign bank or the foreign bank itself chooses to register as a Swap Dealer, Dodd-Frank provides the Commissions with authority to designate and regulate only those branches or agencies that transact with U.S. customers. Specifically, Dodd-Frank's Swap Dealer definitions provide that a "person may be designated as a [swap/security-based swap dealer] for a single type or single class or category of . . . *activities* and considered not to be a [swap/security-based swap dealer] for other types, classes, or categories of . . . *activities*"

[22] CFTC Registration Proposal at 71382.

[23] The Institute acknowledges that the reference to a U.S. underlier or use of a U.S. execution venue could be relevant to the Commissions' exercise of so-called "effects" jurisdiction under appropriate circumstances. ("Effects" jurisdiction generally refers to a U.S. regulator's authority to regulate or prosecute conduct outside the U.S. that has a certain "effect" within the U.S. that is subject to regulation or prohibition.) The extent of the Commissions' effects jurisdiction is beyond the scope of this comment letter. We merely note that determinations with respect to the non-regulation or non-registration of certain activities or persons outside the U.S. do not imply limitations on the scope of the relevant Commission's effects jurisdiction.

[24] The Institute notes that whether registration as an introducing broker, broker-dealer, commodity trading advisor, or investment adviser is required under the relevant provisions will, in a given case, of course depend on the facts and circumstances of the activities conducted by U.S. personnel.

[25] *See* Section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101(b)) (distinguishing between an "agency," a "branch," and a "foreign bank").

(emphases added).[26] Accordingly, in circumstances where it is appropriate to require registration, the Commissions should designate as a Swap Dealer only the particular U.S. or non-U.S. branch or agency of the foreign bank involved in the execution of swaps with U.S. customers.

Moreover, the Institute strongly believes that swaps with a non-U.S. affiliate of a U.S. person should not give rise to Swap Dealer or MSP registration requirements for that non-U.S. affiliate's counterparties located outside the U.S. Although, as noted by the CFTC, market participants are able to transfer swap-related risks within affiliated groups,[27] the Commissions should encourage effective group-wide risk management, not discourage it through unnecessary registration requirements. Moreover, just as the Commissions would expect to regulate the swap activities of a U.S. affiliate of a non-U.S. person, the swap activities of a non-U.S. affiliate of a U.S. person with counterparties located outside the U.S. are more properly the subject of regulation by authorities in the relevant non-U.S. jurisdiction. A contrary result would be inconsistent with Sections 722 and 772 of Dodd-Frank, which do not contain any language suggesting that the territorial limits on the Commissions' jurisdictions with respect to swap activities are subject to an exception in the case of a non-U.S. affiliate of a U.S. person. Furthermore, no financial regulatory statute adopts such an approach to extraterritoriality, since it would effectively prevent U.S. market participants (including corporate end-users) from accessing non-U.S. markets through their non-U.S. affiliates.

The Commissions should also clarify that a non-U.S. person would not be subject to Swap Dealer or MSP registration requirements simply by virtue of contacting a U.S.-domiciled professional fiduciary that acts for a counterparty located outside the U.S., since that counterparty would not expect U.S. Swap Dealer or MSP requirements to apply to swap transactions with a non-U.S. person merely because its account is managed by a U.S.-resident fiduciary. This clarification would be consistent with the SEC's existing approach in the context of foreign broker-dealer registration.[28]

Finally, the Commissions should clarify that a non-U.S. person will not be deemed to be acting as a Swap Dealer within the U.S. solely on the basis of swaps it enters into with U.S.-registered Swap Dealers (including U.S. branches and agencies that are registered) from outside the U.S. This clarification is necessary to preserve access to non-U.S. markets by U.S.-registered Swap Dealers. The existence of a U.S.-registered Swap Dealer on one side of such transactions ensures that the requirements of Title VII are appropriately satisfied. Moreover, this clarification is also consistent with the territorial scope limitations contained in Sections 722 and 772 of Dodd-Frank, since the relevant activity of the non-U.S. person would take place outside the U.S.

II. Application to Common Transaction Paradigms

With the foregoing clarifications in mind, the Institute describes below how its proposed framework for Swap Dealer and MSP registration and regulation would apply to the four most common paradigms under which an unregistered U.S. person may have a foreign bank (or its U.S. branch, agency, or affiliate) as its swap counterparty: (a) transactions directly with a foreign bank acting from abroad without intermediation by a registered Swap Dealer, (b) transactions with a foreign bank as principal intermediated as agent by a U.S. branch, agency, or affiliate that is registered as a Swap Dealer, (c) transactions with a U.S. branch, agency, or affiliate acting as principal in a dealer capacity, and (d) transactions in which the market risk from swap dealing activities is allocated by a registered U.S. branch, agency, or affiliate to the unregistered foreign bank or by a registered foreign bank to its unregistered U.S. branch, agency, or affiliate.

The proposed framework is designed to apply to these paradigms in a complementary fashion to address the structural diversity of the swap markets in a manner that ensures compliance with Dodd-Frank. Accordingly, in the case of each paradigm, (i) the Board would be able to make a determination as to the comparability of the foreign bank's capital in accordance with its longstanding approach to cross-border banking supervision and, in appropriate circumstances, defer to home country capital requirements and prudential supervision and (ii) responsibility for compliance with Dodd-Frank's mandatory clearing and execution, customer business conduct, margin, segregation, and record-keeping requirements would lie with a Commission registrant. Furthermore, the Commissions have the legal authority to

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[26] *See* Sections 1a(49)(B) of the CEA and 3(a)(71)(B) of the Exchange Act, each as amended by Dodd-Frank.

[27] CFTC Registration Proposal at 71382.

[28] *See Cleary, Gottlieb, Steen & Hamilton* (avail. Nov. 22, 1995, revised Jan. 30, 1996).

adopt this framework through interpretation of the extraterritorial application of Dodd-Frank in light of Sections 722 and 772 and, in some cases, through exercise of their definitional authority pursuant to Section 712(d).

The Institute emphasizes that it is not suggesting that the Commissions adopt the proposed framework only for one of the below paradigms. Providing only one option for Swap Dealer and MSP registration and regulation fails to recognize the diversity of business models under which foreign banks operate and would require many foreign banks (and indeed some U.S. banks) to restructure their businesses significantly, which would entail material costs and reduced flexibility for both banks and corporate end-users and other counterparties. The Institute respectfully recommends that the Commissions recognize this diversity and, instead, accommodate multiple dealing structures under appropriate an appropriate regulatory framework so as to facilitate compliance with Dodd-Frank without causing undue disruption to the global derivatives markets.

A. Transactions Directly with a Foreign Bank

There may be circumstances in which a foreign bank chooses to transact in swaps with U.S. customers (as opposed to U.S.-registered Swap Dealers) directly from abroad without U.S. intermediation. For instance, the foreign bank may make its personnel in non-U.S. markets available to execute swap transactions directly with U.S. customers, since those personnel may have more expertise in the relevant market. The foreign bank may also make its non-U.S. personnel available to execute swap transactions with U.S. customers outside U.S. trading hours. Less commonly, some foreign banks may not have qualified personnel at a U.S. branch, agency, or affiliate. In each case, if the foreign bank engages in swap "dealing" activity (*i.e.,* holds itself out as a dealer, makes a market, regularly enters into swaps as a business, or engages in activity causing it to be commonly known as a dealer or market maker) directly into the U.S. from abroad, then it would be subject to Swap Dealer registration in the U.S.[29]

It is imperative that the Commissions adopt an approach for foreign banks that choose to register as Swap Dealers which recognizes that, for reasons of international comity and the necessity of a realistic regulatory approach, U.S. regulators should only oversee those aspects of the foreign bank's swap business that directly affect U.S. counterparties and markets. This would facilitate establishment with the EU and other G20 jurisdictions of a framework for cross-border access by third country firms subject to home country supervision that is determined to be equivalent to that of the host jurisdiction(s).[30]

The Institute notes that a foreign bank that registers with one or both of the Commissions as a Swap Dealer will have the Board as its prudential regulator.[31] Accordingly, the Board will be in a position, in accordance with its longstanding approach to cross-border banking supervision, to assess the adequacy of the foreign bank's capital in cases where the Board determines that the foreign bank Swap Dealer's home country supervisory regime is consistent with the standards required under Dodd-Frank. In the case of other requirements that apply across a Swap Dealer's overall business—such as risk management systems, supervisory policies and procedures, and information barriers—the Institute suggests that the Commissions similarly defer to home country regulation and supervision, where comparable. This is particularly important given that risk management, capital adequacy and related supervisory processes must be implemented on a consolidated basis and structured in light of each other in order to be effective.

On the other hand, Dodd-Frank requirements that apply to a particular transaction, such as mandatory clearing, execution, counterparty business conduct, margin, and segregation requirements, should apply to the foreign bank Swap Dealer with respect to those swaps that involve an unaffiliated U.S. counterparty.[32] The

[29] If personnel of a U.S. branch, agency, or affiliate of the foreign bank Swap Dealer also solicited or negotiated with U.S. customers on behalf of the foreign bank Swap Dealer, then that branch, agency or affiliate would be subject to introducing broker and/or broker-dealer registration, as and to the extent applicable. The branch, agency or affiliate should not separately be subject to Swap Dealer registration unless it acts other than in an agency capacity, such as in the paradigms described in **Parts II.B** and **II.C** below.

[30] *See* notes 17–19, *supra,* and accompanying text.

[31] Section 1a(39) of the CEA, as amended by Dodd-Frank (defining "prudential regulator").

[32] Although Dodd-Frank's margin requirements would apply, those requirements for non-cleared swaps will, for a foreign bank Swap Dealer, be applied by the Board. It would be consistent with the Board's long-standing approach to cross-border banking supervision for it to adopt an approach to margin that is based on deference to home county standards that it deems to be comparable. This approach would, in the Institute's view, also be consistent with the

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Swap Dealer should be permitted to outsource the performance, but not the responsibility for due performance, of those requirements to a U.S. branch, agency, or affiliate.

Consistent with Sections 722 and 772 of Dodd-Frank, those transaction-specific requirements should not, however, apply to swaps by a foreign bank Swap Dealer conducted from outside the U.S. with counterparties located outside the U.S., since those transactions will be subject to non-U.S. regulatory requirements, and such counterparties will not be looking to U.S. regulatory protections in the context of such transactions. This approach is consistent with positions taken by the Commissions under the CEA and the Investment Advisers Act of 1940 (the "*Advisers Act*").[33] This should also be the case if U.S.-based personnel employed by a U.S. branch, agency, or affiliate of the foreign bank Swap Dealer are involved, as agents of the foreign bank, in soliciting or negotiating with the counterparty.[34] The result should be the same if U.S. personnel of a U.S. branch, agency, or affiliate of that counterparty are involved in soliciting or negotiating with the foreign bank.

In the case of record-keeping and related examination requirements, the Commissions should permit records for transactions with U.S. customers to be kept either in the U.S. or, if the Swap Dealer agrees to provide records to the Commissions upon request, outside the U.S.[35] This approach would allow the Commissions to readily examine records for U.S.-related transactions. Records for other transactions should be permitted to be kept in accordance with comparable home country requirements, and the Commissions should examine such records through information sharing agreements, memoranda of understanding, and other similar arrangements with home country regulators. These arrangements should be designed to address concerns that Commission examination of such records might otherwise pose under non-U.S. privacy laws.[36]

The Commissions should also establish a registration and regulatory framework for swap data repositories that limits the extent to which U.S. and non-U.S. market participants might be required to comply with duplicative or inconsistent swap reporting regimes in multiple jurisdictions or to report the same transactions to both U.S. and non-U.S. data repositories.

B. Transactions Intermediated by a U.S. Branch, Agency, or Affiliate

Perhaps more commonly, a foreign bank may transact in swaps as a dealer with U.S. customers through a separate U.S. branch, agency, or affiliate that intermediates the transactions as agent for the foreign bank. This is often because, to facilitate strong relationships with U.S. customers, the personnel who solicit and negotiate with U.S. customers and commit a foreign bank to swaps are located in the U.S. Local personnel may also have greater expertise in local markets.

In this paradigm, the Swap Dealer registration analysis should turn on the status of the intermediating U.S. branch, agency, or affiliate. In cases where the U.S. branch, agency, or affiliate acting as agent is registered merely as an introducing broker and/or securities broker-dealer—and there is no U.S.-resident registered Swap Dealer responsible for the transactions—then the foreign bank should be regarded as engaging in swap dealing activity directly into the U.S. from abroad, and should be subject to registration and regulation as discussed in **Part II.A** above.

In contrast, the U.S. branch, agency, or affiliate acting as agent for the foreign bank may be registered as a Swap Dealer and hold itself out to U.S. customers as such. In such a case, if the U.S. branch, agency, or affiliate complies with Dodd-Frank's transaction-specific mandatory clearing, execution, counterparty business conduct, margin, segregation, and record-keeping requirements as though it were

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standards for margin requirements mandated by Sections 731 and 764 of Dodd-Frank for the reasons discussed in note 11, *supra*.

[33] *See* CFTC Regulations § 4.7(a)(2)(xi) (providing a non-U.S. registered commodity trading advisor with exemptions from certain CEA requirements with respect to its non-U.S. clients) and *União de Bancos Brasileiros S.A.* (avail. July 28, 1992) (concluding that the registered foreign advisory subsidiary of a foreign bank need not comply with U.S. requirements with respect to its non-U.S. clients).

[34] Those personnel would, however, need to comply with U.S. requirements applicable to introducing brokers or securities broker-dealers to the extent that the U.S. branch, agency, or affiliate is so registered and those personnel are acting as employees or associated persons of the registered branch, agency, or affiliate.

[35] This approach is consistent with the CFTC's proposal for record-keeping by Swap Dealers. *See* 75 *Fed. Reg.* 76666, 76669 (Dec. 9, 2010). *See also* Rule 17a–7 under the Exchange Act (establishing a similar regime for non-U.S. broker-dealers) and Rule 204–2(j)(3) under the Advisers Act (establishing a similar regime for non-U.S. advisers).

[36] *See, e.g.,* Article 29 of the EU's Data Protection Directive, Directive 95/46/EC (imposing restrictions on transfer of personal data to non-EU countries).

the swap counterparty,[37] then the Commissions should *not* regard the foreign bank—which would merely be an offshore "booking" center for the swap transactions—to be acting as a Swap Dealer in the U.S. Accordingly, the foreign bank should not be required, under these circumstances, to register with the Commissions as a Swap Dealer.[38]

As a policy matter, this approach would address the objectives of Dodd-Frank. Because a U.S.-registered Swap Dealer would take part in the swap and be responsible for compliance with Dodd-Frank and CFTC/SEC rules, the transaction would be subject to oversight by the Commissions and the U.S. customer would be protected by Dodd-Frank's business conduct requirements and anti-fraud and anti-manipulation provisions.

With respect to counterparty credit risk, there would be no risk as between the U.S. customer and the foreign bank for a cleared swap because the U.S. customer would face the CFTC-registered FCM or SEC-registered broker-dealer acting as clearing member of the derivatives clearing organization or securities clearing agency, not the foreign bank. The foreign bank would be required to post margin as and to the extent required by the rules of the relevant derivatives clearing organization or clearing agency. Also, for swaps cleared in the U.S., the U.S. customer's margin would be protected by a CFTC-registered FCM or SEC-registered broker-dealer or security-based swap dealer, as appropriate.[39]

In the case of a non-cleared swap, the U.S.-registered Swap Dealer would, as noted above, comply with Dodd-Frank's margin and segregation requirements, which would mitigate some measure of credit risk between the U.S. customer and the foreign bank. Although the Institute recognizes that the U.S. customer would still have some residual uncollateralized credit exposure to the foreign bank, the Commissions should address that risk by requiring the U.S.-registered Swap Dealer, as a condition for intermediating non-cleared swaps with U.S. customers as agent for an unregistered foreign bank, to obtain a determination from the Board that the foreign bank is subject to home country capital standards that are consistent with the standards required under Dodd-Frank.[40] Indeed, in a case where the U.S. registered entity intermediating the transaction is a U.S. branch or agency of the foreign bank, then, as a practical matter, the Board will have already made that determination because the Board assesses the capital of a U.S. branch or agency by reference to the capital of the foreign bank itself.[41]

This framework would ensure that a U.S. customer that transacts in swaps with an unregistered foreign bank would be in the same position with respect to its residual uncollateralized credit risk to the foreign bank it would have been in if the foreign bank were registered. This is because, under the framework suggested above, the foreign bank that is the swap counterparty to the U.S. customer would be subject to capital requirements and prudential supervision that the Board has determined to be appropriate, which is all that Dodd-Frank requires or seeks to achieve.[42]

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[37] Because the U.S. branch, agency, or affiliate would be acting solely in an agency capacity, it would not be required to hold capital against the swap positions. Also, where the intermediating Swap Dealer registrant is a U.S. branch or agency of the foreign bank, the Board should defer to comparable home country margin requirements for non-cleared swaps, as discussed in note 32, *supra*.

[38] The Institute notes that this approach would be consistent with the CFTC's interpretive position that a foreign futures commission merchant ("*FCM*") may, without registration as an FCM or exemption under CFTC Regulations Part 30, carry customer omnibus accounts for U.S. customers intermediated through a U.S.-registered FCM. *See* CFTC Interpretive Letter 87–7 (Nov. 17, 1987). It would also be consistent with the SEC's territorial approach to broker-dealer registration. *See* SEC Release No. 34–27017 (Jul. 11, 1989).

[39] The Institute also recommends that the Commissions adopt an approach to cross-border swap clearing that is consistent with the CFTC's approach for foreign FCMs in the futures markets. *See, e.g.,* CFTC Interpretive Letter 87–7, *supra* note 38 (providing a framework for intermediation by a U.S.-registered FCM) and CFTC Regulations § 30.10 (providing a framework for exempting a foreign FCM subject to comparable home country regulation).

[40] The Commissions could adopt this requirement pursuant to their respective general authorities under Section 4s(b)(4) of the CEA and Section 15F(b)(4) of the Exchange Act, each as amended by Dodd-Frank, to adopt rules regarding Swap Dealers and MSPs, including limitations on activity. Alternatively, they could adopt this requirement pursuant to their definition authority under Section 712(d) of Dodd-Frank as a condition to an exclusion from the Swap Dealer and MSP definitions for the foreign bank.

[41] *See* note 8, *supra*.

[42] The Institute notes that Title VII of Dodd-Frank anticipates that some degree of non-cleared swap activity will continue to take place, and so it is implicit that Dodd-Frank does not require the elimination of all credit risk of U.S. swap customers to Swap Dealers. Rather, Dodd-Frank

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Additionally, applying the same analysis, where (a) a U.S.-registered Swap Dealer intermediates transactions with U.S. customers as agent for the foreign bank and complies with Dodd-Frank's transaction-level requirements as though it were the swap counterparty and (b) the foreign bank is subject to home country capital requirements determined by the Board to be consistent with Dodd-Frank, the swap positions of the foreign bank with those U.S. customers and the related credit exposures to which they give rise would not, in the Institute's view, pose the exceptional risks to the U.S. financial system that are the basis for the MSP definitions. Accordingly, a foreign bank should not be subject to MSP registration in these circumstances.

As a legal matter, the Commissions could adopt this approach as an interpretation of the limited extraterritorial application of the Swap Dealer and MSP registration requirements contained in Sections 731 and 764 and use their general rulemaking authority for Swap Dealers and MSPs to apply any additional conditions to the U.S.-registered Swap Dealer acting as agent for the unregistered foreign bank. Alternatively, the Commissions could use the broad authority granted to them by Section 712(d) to adopt rules regarding the Swap Dealer and MSP definitions that would conditionally exclude a foreign bank subject to home country capital standards deemed comparable by the Board from those definitions if its only swaps with U.S. customers are executed through a U.S.-registered Swap Dealer acting as agent. Indeed, in the context of the MSP definitions, the Commissions have already suggested that Section 712(d) gives them the flexibility to adopt conditional or unconditional exclusions.[43]

C. Transactions with a U.S. Branch, Agency, or Affiliate Acting as Principal in a Dealer Capacity

There are also circumstances under which a U.S. branch, agency, or affiliate of a foreign bank may choose to transact in swaps as a dealer with counterparties located within and outside the U.S. as principal and acting in a dealer capacity, such as when it has existing, documented relationships with those counterparties or when those customers prefer, for insolvency, tax or other reasons, to transact with a U.S. branch, agency, or affiliate. In those cases, the U.S. branch, agency, or affiliate would register with the Commission(s) as a Swap Dealer and comply with Dodd-Frank's business conduct and other regulatory standards in connection with all of its swap activity conducted from the U.S.[44] However, consistent with Sections 722 and 772 of Dodd-Frank, the foreign bank itself should not be subject to registration or regulation as a Swap Dealer or MSP simply by virtue of its relationship with the registered U.S. branch, agency, or affiliate.

D. Inter-affiliate or Inter-branch Transactions

In order to centralize risk management, a foreign bank's U.S. branch, agency, or affiliate that is registered as a Swap Dealer may use swap transactions to allocate some or all of the market risk arising from its swap dealing activities to the foreign bank through back-to-back transactions or other similar arrangements. Similarly, a foreign bank that is registered as a Swap Dealer may use swap transactions to allocate the market risk arising from its swap dealing activities to an unregistered U.S. branch, agency, or affiliate so that personnel employed by that U.S. branch, agency, or affiliate can manage that risk. By way of example, such arrangements can be used so that a foreign bank's U.S. dollar interest rate portfolio is managed centrally by expert personnel in the U.S. In each case, the participating unregistered entity should not be required to register as a Swap Dealer or MSP.

As noted by the Commissions in the Joint Definition Proposal, swaps between persons under common control simply represent an allocation of risk within a corporate group, and may not involve the interaction with unaffiliated persons that is a hallmark of the elements of the Swap Dealer definitions that refer to holding oneself out as a dealer or being commonly known as a dealer.[45] The Commissions also recognized that such swaps may not pose the exceptional risks to the U.S. financial system that are the basis for the MSP definitions.[46] This is particularly the case where, as here, there are *bona fide* commercial reasons for the registered U.S. branch, agency, or affiliate or registered foreign bank to structure transactions

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addresses that risk by requiring that Swap Dealers be subject to capital requirements and prudential supervision.

[43] Joint Definitions Proposal at 80202–03.

[44] In the case of a U.S. branch or agency that registers as a Swap Dealer, the Board or the OCC, as applicable, should look to the capital adequacy of the foreign bank in determining whether the branch satisfies Dodd-Frank's capital requirements.

[45] Joint Definitions Proposal at 80183.

[46] *Id.* at 80202.

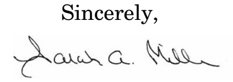
through back-to-back or similar inter-affiliate or inter-branch arrangements. Since those arrangements would, in each case, involve a registered entity, there should be no concern that they could be used to evade Swap Dealer or MSP requirements.[47] Accordingly, such transactions should not give rise to Swap Dealer or MSP registration requirements.[48]

Additionally, the Institute urges the Commissions to consider which, if any, of Dodd-Frank's other swap-related requirements should be applicable to such inter-affiliate or inter-branch risk management transactions. Application of Dodd-Frank's mandatory clearing, execution, or margin requirements to such transactions would in some instances completely prevent, and in others seriously reduce the efficiency of, those transactions—thereby undermining Dodd-Frank's objective of mitigating systemic risk. Additionally, requirements intended to protect customers, such as Dodd-Frank's business conduct requirements, also plainly are not necessary in the case of inter-affiliate or inter-branch transactions.

* * * * *

The Institute appreciates the opportunity to submit these comments in connection with the Commissions' Proposed Rules. Please do not hesitate to contact the undersigned at [**Redacted**] with any questions or if we can be of assistance to the Commissions.

Sincerely,



SARAH A. MILLER,
Chief Executive Officer,
Institute of International Bankers.

CC:

JENNIFER J. JOHNSON,
Secretary,
Board of Governors of the Federal Reserve System.

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[47] Transactions between persons under common control that are designed to evade Swap Dealer or MSP requirements should, if necessary, be addressed by appropriate Commission anti-evasion rules.

[48] In the Institute's view, the MSP definition should not be interpreted to encompass an affiliate of a named counterparty to a swap that provides a guarantee of the named counterparty's obligations. This is particularly the case where the affiliate providing the guarantee is a foreign bank or other non-U.S. entity, since risk held by a non-U.S. entity is more properly the subject of regulation by non-U.S. authorities.

ATTACHMENT 1

Institute of International Bankers:

Proposed Framework for Swap Dealer Registration and Regulation

In order to assist the agencies in structuring their swap dealer registration and regulatory frameworks for foreign banks, and to ensure that the agencies' frameworks do not give rise to market disruption by failing to accommodate the structuring alternatives that must be available to foreign firms, we have summarized below a registration and regulatory framework that we believe appropriately applies sound principles of home/host country regulation in the context of Title VII of the Dodd-Frank Act.[1]

The paradigms outlined in this matrix represent the principal (although not the only) structuring paradigms that foreign firms employ to structure their cross-border swap and security-based swap (hereinafter, "swap") business with U.S.-domiciled counterparties. Individual banks often use different structural paradigms for swaps involving different asset categories, and individual variations on these pure paradigms are not uncommon. No single paradigm would suffice to meet the needs and circumstances of all foreign banks and we do not believe that it is necessary or desirable to impose any single paradigm on foreign banks-whether the bank is ultimately U.S. owned or non-U.S. owned. This matrix illustrates how supervision and oversight of swap dealers can be established under each of the paradigms in a manner that is compliant with the provisions and objectives of Title VII.

We also note that, as an integral part of this framework, it is critical that the relevant U.S. and home country regulators agree upon an appropriate framework for examination, direct supervisory responsibility and access to information that is consistent with the allocation of applicable host/home country law.

	Direct Contacts by Foreign Bank Personnel	**U.S. Branch Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. FCM/Broker-Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. Swap Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. Affiliate Deals in Swaps as Principal**
Facts	Employees of the foreign bank resident outside the U.S. contact U.S. persons to deal in swaps that the foreign bank enters into as principal. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be hedged through inter-branch or inter-affiliate swaps.	Employees of a U.S. branch, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be hedged through inter-branch or inter-affiliate swaps.	Employees of a U.S. futures commission merchant ("*FCM*")/broker-dealer affiliate, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be hedged through inter-branch or inter-affiliate swaps.	Employees of a U.S. swap dealer affiliate, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be hedged through inter-branch or inter-affiliate swaps.	Personnel employed by a U.S. affiliate contact U.S. persons to deal in swaps for the account of the U.S. affiliate. Some or all of the risk arising from this swap activity might be backed-to-back to the foreign bank.

Registration (Commodity Exchange Act ("*CEA*") § 4s(a)(1)/Securities Exchange Act of 1934 ("*SEA*") § 15F(a)(1))	The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S.-facing activities of the branch/separately identifiable department or division that is involved in the execution of swaps with U.S. persons. Other branches/divisions would not be subject to U.S. regulation.	The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S. branch activities. Foreign branches would not be subject to U.S. regulation.	The U.S. affiliate, since it is engaged in soliciting and accepting orders for swaps on behalf of the foreign bank, would register as an introducing broker or securities broker (or, if it is registered as an FCM/broker-dealer, otherwise qualify). The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S.-facing activities.	The U.S. affiliate would register as a swap dealer. The foreign bank "booking entity" would either register in the U.S. as a swap dealer solely with respect to its role as the contractual counterparty on U.S. customer-facing swaps *or,* as a condition to not registering, be required to be subject to and comply with home country standards determined by the FRB and the Commissions, as applicable, to be comparable to U.S. capital, risk management, and other prudential requirements (in which case the foreign bank would undertake to notify the FRB and the Commissions of any violations of or material changes to those home country standards, which could constitute a basis for revoking the exception from registration).	The U.S. affiliate would register as a swap dealer. The foreign bank affiliated with the U.S. swap dealer would not be subject to U.S. regulation, including in cases where: (a) market risk is hedged back to the foreign bank by the U.S. swap dealer; and/or (b) the foreign bank guarantees the U.S. swap dealer's obligations.
Capital (CEA § 4s(e)/ SEA § 15F(e))	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	The U.S. swap dealer affiliate would comply with U.S. capital requirements, as established by the Commissions. Under these requirements, the U.S. swap dealer affiliate would not be required to hold capital against the market and credit risk arising from positions booked in the foreign bank so long as either: (a) the foreign bank counterparty registers as a swap dealer, in which case the FRB would defer to comparable home country standards, and failure to comply with those standards would constitute a violation of FRB rules by the foreign bank; or (b) the U.S. swap dealer affiliate obtains a determination from the FRB that the foreign bank booking entity is subject to comparable home country capital standards and undertakes to notify the FRB and the Commissions of any violations of or material changes to those standards, which could constitute a basis for revoking the exception from registration.	The U.S. swap dealer affiliate would comply with U.S. capital requirements, as established by the Commissions or the relevant prudential regulator.

Institute of International Bankers:—Continued

Proposed Framework for Swap Dealer Registration and Regulation

	Direct Contacts by Foreign Bank Personnel	U.S. Branch Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. FCM/Broker-Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Swap Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Affiliate Deals in Swaps as Principal
Margin (CEA § 4s(e)/ SEA § 15F(e))	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	Foreign banks would agree to comply with U.S. requirements applicable to the affiliate for transactions intermediated by the affiliate.	The U.S. swap dealer affiliate would comply with U.S. margin requirements, as established by the Commissions or the relevant prudential regulator.
Financial and Operational Records (CEA § 4s(f)(1)/ SEA § 15F(f)(1)) [2]	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	The U.S. swap dealer affiliate would comply with Commission requirements. For the limited registration foreign bank swap dealer, if any, the Commissions would defer to comparable home country standards, and failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	The U.S. swap dealer affiliate would comply with Commission requirements.
Risk Management Procedures (including Business Continuity/Disaster Recovery) (CEA § 4s(j)(2)/ SEA § 15F(j)(2))	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	The U.S. swap dealer affiliate would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. For the limited registration foreign bank swap dealer, if any, the Commissions would defer to comparable home country standards, and failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.

Conflicts of Interest (including Information Barriers) (CEA § 4s(j)(5)/ SEA § 15F(j)(5))	Where comparable (*i.e.,* reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Where comparable (*i.e.,* reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Where comparable (*i.e.,* reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.
Position Limits/ Monitoring of Trading (CEA §§ 4s(h)(1)(C) and (j)(1)/SEA §§ 15F(h)(1)(C) and (j)(1))	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.
Diligent Supervision (CEA § 4s(h)(1)(B)/ SEA § 15F(h)(1)(B))/ Chief Compliance Officer (CEA § 4s(k)/ SEA § 15F(k))	The branch/division that is involved in the execution of swaps with U.S. persons would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with these requirements. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs.	The U.S. branch would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the U.S. branch as responsible for complying with these requirements. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	The foreign bank, in conjunction with the U.S. FCM/Broker-dealer affiliate, would establish an integrated system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel at the foreign bank, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.

Institute of International Bankers:—Continued

Proposed Framework for Swap Dealer Registration and Regulation

	Direct Contacts by Foreign Bank Personnel	U.S. Branch Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. FCM/Broker-Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Swap Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Affiliate Deals in Swaps as Principal
Business Conduct Standards with Counterparties (CEA §§ 4s(h)(3), (4) and (5)/SEA §§ 15F(h)(3), (4) and (5))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would outsource the performance, but *not* responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.
Back Office/Documentation Standards (CEA § 4s(i)/SEA § 15F(i)) [3]	U.S. requirements that apply to particular transactions/counterparties (*e.g.,* acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with these requirements. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	U.S. requirements that apply to particular transactions/counterparties (*e.g.,* acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the U.S. branch as responsible for complying with these requirements. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	U.S. requirements that apply to particular transactions/counterparties (*e.g.,* acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would outsource the performance, but *not* responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.

Trading Records (CEA § 4s(g)/ SEA § 15F(g))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would outsource the performance, but *not* responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs. Books and records relevant to compliance with respect to all activities conducted by the U.S. affiliate on behalf of the foreign bank swap dealer would be accessible in the U.S. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.
Segregation Requirements (CEA § 4s(l)/SEA § 3E(f))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would outsource the performance, but *not* responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.[4]	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer- facing activity occurs.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.

[1] While this framework is, for convenience, described with reference to a foreign bank, the same framework would also apply to a foreign, non-bank financial institution, except that the Commodity Futures Trading Commission ("*CFTC*") and the Securities and the Exchange Commission (the "*SEC*" and, together with the CFTC, the "*Commissions*"), rather than the Board of Governors of the Federal Reserve System (the "*FRB*"), would be responsible for capital and margin requirements.

[2] U.S. regulators would, in consultation with home country regulators, establish an allocation for the exercise of examination authority and access to financial, operational, and other supervisory information.

[3] To the extent that the Commissions adopt portfolio compression requirements pursuant to these provisions, we would regard those requirements, like risk management requirements, as integrally related to capital adequacy and overall safety and soundness. Accordingly, under this framework, the Commissions would defer to comparable home country standards designed to address the same objectives as the Commissions' portfolio compression requirements, and failure to comply with home country standards would constitute a violation of Commission rules.

[4] As discussed above, books and records relevant to compliance with respect to all activities conducted by the U.S. affiliate on behalf of the foreign bank swap dealer would be accessible in the U.S.

ATTACHMENT 2

April 11, 2011

Regulation and Supervision of U.S. Branches and Agencies of Foreign Banks by U.S. Banking Authorities and the Application of U.S. Regulatory Capital Requirements to Such Banks

Banking organizations headquartered outside the United States ("foreign banks") conduct a substantial portion of their banking activities in the United States through branch offices of the bank[1] pursuant to licenses granted either by New York or one of the other states or, if the foreign bank so chooses, by the Office of the Comptroller of the Currency ("OCC").[2] In the aggregate, U.S. branches of foreign banks hold over $2 trillion of assets, accounting for approximately 15% of total banking assets in the United States.[3]

The discussion below summarizes key aspects of how U.S. branches of foreign banks are regulated and supervised in the United States as separately licensed offices of the banks, focusing in particular on the key role the Federal Reserve plays in this process. This brief review is followed by a discussion of how the Federal Reserve, in applying U.S. capital requirements to foreign banks that maintain U.S. branches, gives appropriate deference to home country standards while providing sufficient flexibility to ensure compliance with U.S. regulatory capital requirements in a manner that is consistent with national treatment.

The U.S. Bank Regulatory Approach to U.S. Branches as Separately Licensed Offices of Foreign Banks

U.S. branches are not separately capitalized entities, but their operations are separately examined by U.S. banking authorities and assigned supervisory "ROCA" ratings.[4] In addition, U.S. branches maintain separate books and records in accordance with U.S. regulatory requirements and file with U.S. regulators quarterly reports of their assets and liabilities ("Call Reports").

In general, U.S. branches are limited to the same types of activities as are permissible for their U.S. domestic bank counterparts. Inasmuch as foreign banks' U.S. branches do not have their own capital, restrictions on such activities that are based on capital (for example, lending limits) are applied to branches by reference to the foreign bank's capital, as calculated under its home country standards.

U.S. regulators have the authority to take over and oversee the liquidation of the operations of U.S. branches. These proceedings are undertaken pursuant to so-called "ring-fencing" provisions whereby the assets of the branch are distributed first to satisfy the claims of creditors that have done business with the branch, with the balance, if any, then distributed to the appropriate authority in the foreign bank's home country.

Federal Reserve Regulation and Oversight of U.S. Branches of Foreign Banks

The Federal Reserve plays an especially important role in the regulation and oversight of foreign banks and their U.S. branches. Foreign banks seeking to enter the U.S. market through a branch are required to obtain the Federal Reserve's prior approval (as well as approval from the appropriate Federal or state licensing au-

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[1] Strictly speaking, foreign banks may establish "branches" and "agencies" in the United States, the principal difference between the two types of offices being that a "branch" is authorized to accept deposits from U.S. persons but an "agency" is not. Foreign banks conduct principally wholesale banking activities through their branches and agencies. The deposits of branches are not insured by the FDIC (with the exception of eight foreign banks that are permitted, pursuant to "grandfather" authority granted under Federal banking law, to maintain FDIC-insured branches subject to the same limits on deposit insurance coverage applicable to all other FDIC-insured depository institutions (according to the Federal Reserve data referenced in note 2 below, these grandfathered insured branches have less than $30 billion total assets in the aggregate)).

[2] According to the information most recently published by the Federal Reserve (reported as of September 30, 2010), there are 199 state-licensed foreign bank branches and agencies, 106 of which are licensed by the New York State Banking Department. According to information most recently published by the OCC (reported as of February 28, 2011), there are 51 Federal branches and agencies, 35 of which are located in New York.

[3] According to the Federal Reserve data, state-licensed branches and agencies in the aggregate have total assets of approximately $1.89 trillion (of which $1.81 trillion is held by branches), and Federal branches and agencies have total assets of approximately $140 billion (almost all of which is held by branches).

[4] The "ROCA" rating system consists of separate assessments of a branch's ***r***isk management, ***o***perations, ***c***ompliance and ***a***sset quality, as well as an overall composite assessment of the branch.

thority). In reviewing an application to establish a branch, the Federal Reserve takes into account, among other considerations, the financial and managerial resources of the foreign bank, and the Federal Reserve may impose such conditions on its approval as it deems necessary.[5]

A key consideration in acting on an application to establish a U.S. branch is whether the foreign bank is subject to "comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country."[6] In addition, in the case of an application by a foreign bank that "presents a risk to the stability of the United States financial system," the Federal Reserve may consider "whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk."[7]

The Federal Reserve considers a variety of factors in determining whether a foreign bank satisfies the "comprehensive consolidated supervision" ("CCS") requirement.[8] In the event the Federal Reserve is unable to find that a foreign bank meets the CCS requirement, the Federal Reserve nevertheless may permit the bank to establish a U.S. branch if it determines that "the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank."[9]

The Federal Reserve has the authority to examine each foreign bank's U.S. branch. In exercising this authority the Federal Reserve seeks to coordinate with the appropriate state or Federal authority to the extent possible to reduce burden and avoid unnecessary duplication of examinations, and it may request that its examination be conducted simultaneously with that of the other appropriate examining authority.[10]

The Federal Reserve also has the authority to order a foreign bank to terminate the activities of its state-licensed branch upon its determination, after notice and an opportunity for a hearing and notice to the appropriate state bank supervisor, that there is reasonable cause to believe that the foreign bank, or any of its affiliates, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States.[11]

Federal Reserve Regulation and Oversight of Foreign Banks' U.S. Operations—Application of Capital Requirements to Foreign Banks That Maintain U.S. Branches

The Federal Reserve exercises broad regulatory and oversight authority over not only the operations of foreign banks' U.S. branches, but also their overall U.S. oper-

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[5] *See generally,* 12 U.S.C. 3105(d).

[6] *See* 12 U.S.C. 3105(d)(2)(A).

[7] This factor was added by Section 173(a) of the Dodd-Frank Act, *codified at* 12 U.S.C. 3105(d)(3)(E).

[8] The relevant provisions of the Federal Reserve's Regulation K (12 CFR 211.24(c)(1)(ii)) provides that in making a CCS determination, the Federal Reserve shall assess, among other factors, the extent to which the foreign bank's home country supervisor:

> (A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;
>
> (B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;
>
> (C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;
>
> (D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;
>
> (E) Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

[9] *See* 12 U.S.C. 3105(d)(6)(A)(i)).

[10] *See generally,* 12 U.S.C. 3105(c)(1).

[11] *See* 12 U.S.C. 3105(e)(1)(B). In addition, in the case of a foreign bank that "presents a risk to the stability of the United States financial system," the Federal Reserve may order the bank to terminate the activities of its state-licensed branch if the Federal Reserve finds that "the home country of the foreign bank has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk." (This latter authority was added by Section 173(b) of the Dodd-Frank Act, *codified at* 12 U.S. C. 3105(e)(1)(C).) In the case of a Federal branch, the Federal Reserve is authorized to recommend to the OCC that it terminate the license of the Federal branch on the basis of the same types of concerns that can trigger termination of a state-licensed branch's activities.

ations, both banking and non-banking.[12] Consistent with the international framework for the supervision of cross-border banking activities, this approach reflects the understanding that foreign banks are subject to primary supervision by their home country authorities, with the Federal Reserve, as a host country supervisor, exercising appropriate oversight of their U.S. operations.

A foreign bank that maintains a U.S. branch is treated as a bank holding company and as such is subject to the requirements of the Bank Holding Company Act ("BHC Act"), including its activity restrictions, "in the same manner and to the same extent that bank holding companies are subject to such provisions."[13] Dating to the International Banking Act of 1978, the policy of national treatment has been the guiding principle for implementing these requirements. This principle calls for "parity of treatment between [foreign and U.S. banks] in like circumstances,"[14] but it is recognized that parity of treatment does not mean identical treatment. Instead, national treatment is accomplished by applying the requirements applicable to U.S. banking organizations in a manner that appropriately takes into account the differences resulting from foreign banks' operating in the United States through U.S. branches.

The practical consequences of implementing the national treatment principle are well illustrated by the approach taken by the Federal Reserve when applying U.S. regulatory capital requirements to foreign banks that maintain U.S. branches. This approach recognizes that (i) a U.S. branch does not maintain its own capital and (ii) the foreign bank itself is subject to capital requirements prescribed by its home country authority. In the case of a foreign bank whose home country applies capital standards consistent with those adopted by the Basel Committee on Banking Supervision (the "Basel Committee"),[15] the bank's capital as calculated under those standards is accepted as the starting point for the U.S. regulatory assessment.[16] In the case of banks that are subject to Basel II's requirements, this assessment takes into account any transitional provisions implemented by the home country. If a foreign bank's home country has not adopted capital standards consistent with the Basel Committee's standards, then the foreign bank, rather than being able simply to utilize the ratios calculated under the home country standard as the basis for the U.S. regulatory assessment, is subject to a finding by the Federal Reserve that its capital is equivalent to the capital that would be required of a U.S. banking organization.[17] That finding, however, is based on the assessment of the home country standards and does not call for the foreign bank to calculate its capital using U.S. standards.

Thus, the analysis of a foreign bank's capital properly takes as its starting point the standards of the bank's home country and then undertakes to assess how those standards compare to the standards applicable to U.S. banking organizations under U.S. requirements. This approach neither gives complete deference to home country capital requirements nor requires a foreign bank strictly to abide by each of the U.S. requirements or to calculate its capital pursuant to U.S. rules.

The purpose of the analysis is not to force the foreign bank to conform its capital to U.S. requirements, but instead to determine whether the foreign bank's capital as calculated under its home country requirements is sufficiently equivalent or comparable to that applicable to a similarly situated U.S. banking organization. Consistent with national treatment, this approach recognizes that for U.S. regulatory purposes there is no need to ascertain whether home country requirements are identical to those of the United States. This approach provides the Federal Reserve flexibility in making determinations regarding foreign banks' capital without imposing on foreign banks any requirement to apply U.S. standards in calculating their capital ratios.

For example, one of the requirements applicable to a U.S. bank holding company that elects to operate as a financial holding company ("FHC"), and thereby engage in the expanded securities underwriting and dealing, merchant banking, insurance

[12] *See, e.g.,* "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations," Federal Reserve Supervision and Regulation Letter 08–9 (October 16, 2008).

[13] *See* 12 U.S.C. 3106(a).

[14] S. Rep. No. 1073, 95th Cong. 2d Sess. 2, *reprinted in* 1978 U.S. CODE CONG. AND ADMIN. NEWS 1421, 1422.

[15] In its 2010 survey of countries around the world to measure the progress that has been made with respect to implementation of the revised international capital accords adopted by the Basel Committee in 2006 ("*Basel II*") the Financial Stability Institute found that 112 of the 133 countries responding to the survey have implemented or are currently planning to implement Basel II. *See* "2010 FSI Survey on the Implementation of the New Capital Adequacy Framework," *Occasional Paper No. 9* (August 2010).

[16] *See, e.g.,* 12 CFR 225.2(r)(3)(i)(A).

[17] *See, e.g.,* 12 CFR 225.2(r)(3)(i)(B).

and other non-bank financial activities that are permissible for FHCs under the BHC Act (as amended by the Gramm-Leach-Bliley Act), is that each of its insured depository institution subsidiaries be maintained in a "well capitalized" condition.[18] To be well capitalized, each such subsidiary must have risk-based tier I and total risk-based capital ratios equal to at least 6% and 10%, respectively. In the case of determining whether a foreign bank that maintains a U.S. branch is well capitalized for FHC purposes, Section 4(l)(3) of the BHC Act requires the Federal Reserve to apply "comparable" standards, "giving due regard to the principle of national treatment and equality of competitive opportunity."[19]

In implementing the provisions of Section 4(l)(3) with respect to a foreign bank whose home country has adopted risk-based capital standards consistent with those prescribed by the Basel Committee, the Federal Reserve requires the foreign bank to meet the 6%/10% minimum risk-based capital requirement applicable to domestic FHCs, but this determination is based on the bank's risk-based capital ratios as calculated under its home country standards.[20] In addition, the foreign bank's capital must be comparable to the capital required for a U.S. bank owned by an FHC.[21] If the foreign bank's home country has not adopted capital standards consistent with those of the Basel Committee, then the bank must obtain a determination from the Federal Reserve that its capital (as calculated under home country standards) is otherwise comparable to the capital that would be required of a U.S. bank owned by an FHC.[22] For purposes of assessing comparability, the Federal Reserve may consider additional factors, including the composition of the foreign bank's capital, the ratio of the foreign bank's tier I capital to total assets ("leverage ratio"), home country accounting standards, the foreign bank's long-term debt ratings, its reliance on government support to meet capital requirements and whether it is subject to comprehensive supervision or regulation on a consolidated basis.[23]

Thus, consistent with national treatment, the approach taken by the Federal Reserve with respect to assessing the capital of foreign bank FHCs that maintain U.S. branches gives appropriate deference to home country standards while providing sufficient flexibility to ensure compliance with the U.S. "well capitalized" regulatory requirement.

Mr. NEUGEBAUER. Thank you and now Mr. O'Connor.

STATEMENT OF STEPHEN O'CONNOR, CHAIRMAN, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION; MANAGING DIRECTOR, MORGAN STANLEY, NEW YORK, NY

Mr. O'CONNOR. Thank you. Thank you, Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee for inviting me here today. The issues you are exploring are of vital interest and concern to financial institutions around the world and in particular U.S. institutions, the U.S. financial markets, and to the thousands of U.S. companies who use those markets to manage their risk and finance their growth.

I would like to focus this morning on three key issues. The first concerns the applicability of the U.S. regulations to both U.S. companies and foreign companies. The second relates to the pace and scope of implementation of Dodd-Frank in the U.S., and the third centers on key policy differences emerging between the U.S. and Europe on derivatives regulation. Each of these issues gives rise to its own specific concerns and all three have the potential to create competitive disadvantages for U.S. firms and for the U.S. economy.

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[18] *See* 12 U.S.C. 1843(l)(1)(A). Section 606(a) of the Dodd-Frank Act added the new requirement that the bank holding company itself also satisfy the FHC "well capitalized" requirement. As discussed in the text below, in the case of a foreign bank that is treated as a bank holding company because it maintains a U.S. branch the FHC well capitalized requirement already applies to the foreign bank itself.
[19] *See* 12 U.S.C. 1843(l)(3).
[20] *See* 12 CFR 225.90(b)(1)(i) and (ii).
[21] *See* 12 CFR 225.90(b)(1)(iii).
[22] *See* 12 CFR 225.90(b)(2)
[23] *See* 12 CFR 225.92(e).

Let me say very clearly at the outset, the institution that I represent today, the International Swaps and Derivatives Association squarely supports financial regulatory reform. ISDA's membership includes banks, investment managers, corporations, pension funds, and governmental entities. ISDA has worked hard to make the OTC derivatives market safe and efficient since its founding in 1985.

In the years leading up to the passage of Dodd-Frank and since then, ISDA and other industry associations have worked hard to implement a structured improvements—structural improvements in the global OTC derivatives markets. These structural improvements have served to significantly decrease systemic risk in three key areas: reduce counterparty credit risk, increased transparency, and improved operational infrastructure. In these and other ways ISDA and market participants are demonstrating our commitment to build robust, stable, financial markets and a strong regulatory framework.

So turning to my first point, the issue of extraterritoriality has become a topic of much concern to financial market participants. Extraterritoriality refers to the reach of one's jurisdiction's laws to activities conducted outside of that jurisdiction, and also to institutions operating within the jurisdiction but not based in it. To date, there has been a lack of clarity about how the provisions of the Dodd-Frank Act, and the rules subsequently issued by the CFTC and the SEC, pertain to foreign subsidiaries and branches of U.S. banks and to foreign banks and their subsidiaries in the U.S.

Recently, U.S. regulators issued rules that included provisions requiring extraterritorial application of rules regarding margin requirements. If this expansive approach were adopted by U.S. regulators with regard to the broader rule sets it could create serious issues for U.S. competitiveness. In overseas markets, foreign clients of U.S. firms would be motivated to transact with foreign financial institutions to avoid the reach of Dodd-Frank.

The extraterritoriality provisions are inconsistent with Congressional intent regarding the scope of the new regulatory framework for derivatives. The Congress included provisions in Dodd-Frank that explicitly require that regulators impose the regulations outside the U.S. only if there is a direct and significant connection with U.S. activities or commerce, or as necessary to avoid evasion of Dodd-Frank. These provisions were intended to appropriately balance the protection and safety of the financial system with the competitiveness of U.S. institutions which is also necessary for a healthy U.S. banking system. Clearly the extraterritoriality issue is one that requires careful and thoughtful deliberation.

That leads me to my second point today. Such deliberation is extremely difficult to achieve given the scope and pace of the regulatory reform efforts that are currently underway. The Commissions have an enormous task on their hands. The volume of rulemaking is large, very complicated, and there are significant interdependencies among many of the rules. Many market participants do not know whether or how or when the new rules will apply to them. All of this creates great uncertainty.

The speed of implementation also unintentionally creates competitive disadvantage for U.S. firms. The fact that U.S. firms will likely be subject to a new regulatory framework well before complimentary frameworks are established in other key jurisdictions is itself a cause for concern. Similarly, there is a significant amount of uncertainty for the many well-regulated non-U.S. firms who are members of ISDA and who operate in U.S. markets.

The Commissions have the flexibility to determine the effective dates for many of their finalized rules. ISDA has discussed with the Commissions suggested approaches that would phase in the implementation of the new rules, and ISDA's approach is based on a series of key principles that we believe should govern the implementation schedule. These principles are outlined in more detail in a letter that we have attached with our written testimony. We advocate an approach whereby rules that address systemic risk such as clearing and data repositories should be implemented first.

My last comments on the scope and pace of implementation is that given the rush to get the rules out and the complexities and interactions between the various rules, there should be a final review of the rules once they are all completed. This would give market participants the ability to review and commentate on—comment on the whole rule set. Comments that were provided earlier in the process might be inappropriate in the light of later rule proposals.

Turning now to my third and final point, OTC derivatives market participants are concerned by the potentially divergent approaches being taken in key regulatory jurisdictions. Much of the regulatory framework for the EU is still under discussion and there is significant concern that the EU's approach could differ significantly from the U.S. approach. Requirements for the use and structure of execution platforms, capital, and margin requirements together with business standard rules could differ substantially between regimes. It is too early to know for sure what frameworks will be adopted in the EU, but EU officials have indicated publicly that it is not their intention to change the structure of the OTC derivative markets. E.C. is focusing on key systemic issues arising from the financial crisis that have been identified by the G20 and the Financial Stability Board, namely credit, counterparty credit risk, regulatory transparency, and market infrastructure.

In conclusion, while some differences between jurisdictions in terms of the details of the rules are inevitable, a far greater degree of convergence is essential to the long term health of the global financial system and to the relative standing of the U.S. financial system and financial systems globally. We ask the policymakers to avoid introducing rules in a way that leads to a significant level of divergence between markets.

Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, thank you for your time today. Let me close by reiterating ISDA's support for stronger, more robust financial regulatory frameworks, and safer, more efficient OTC derivative markets. I would be happy to answer any questions that you might have.

[The prepared statement of Mr. O'Connor follows:]

PREPARED STATEMENT OF STEPHEN O'CONNOR, CHAIRMAN, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION; MANAGING DIRECTOR, MORGAN STANLEY, NEW YORK, NY

Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee:

Thank you for the opportunity to testify today. The issues you are exploring are of vital interest and concern—not only to U.S. financial institutions, but more broadly to the U.S. financial markets, and to the thousands of U.S. companies who use those markets to fund their growth and manage their risks.

In the time allotted to me this morning, I would like to focus in particular on three key issues:

The first concerns the applicability of U.S. regulations to both U.S. companies and non-U.S. companies. The second relates to the pace and scope of the implementation of the Dodd-Frank Act in the U.S. And the third centers on key policy differences emerging between the U.S. and EU on derivatives regulation.

Each of these issues gives rise to its own specific concerns, which I will discuss in more detail. But all three are also inter-related in that they have the potential to create competitive disadvantages for U.S. firms and for the U.S. economy.

They could, in effect, create an uneven playing field and they would do so without making that playing field substantially safer or better or more robust. Finally, we at ISDA do not believe these issues address the public policy goals that gave rise to the Dodd-Frank Act and similar efforts in other jurisdictions.

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Let me state very clearly at the outset: both the institution that I represent today—the International Swaps and Derivatives Association—and the firm where I have worked for some 23 years—Morgan Stanley—squarely support financial regulatory reform. What's more, we have worked actively and engaged constructively with policymakers in the U.S. and around the world to achieve this goal.

ISDA, in fact, has worked to make over-the-counter (OTC) derivatives markets safe and efficient since its founding in 1985.

Over the past 3 decades, ISDA has 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 800 members from 56 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

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 to deliver structural improvements to the global over-the-counter (OTC) derivatives markets.

These structural improvements, which have helped to significantly decrease systemic risk, involve three key areas—reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure.

To reduce counterparty credit risk, ISDA and the industry have embraced central clearing of derivatives transactions. Today, the industry has cleared approximately 50 percent of outstanding interest rate swaps volume and over $17 trillion of credit default swaps volume. OTC derivatives have been cleared since 2000, with clearing arising from the industry proactively working with clearing houses to develop a better way for managing counterparty.

To improve regulatory transparency, ISDA and market participants have established trade repositories for interest rate, credit default and equity swaps and is in the process of doing so for commodity swaps. These repositories provide global regulators with unprecedented visibility into risk exposures in the OTC derivatives markets.

To strengthen the industry's operational infrastructure, ISDA and market participants have worked to standardize and automate middle and back office processes.

In these and other ways, ISDA and the industry are demonstrating our commitment to build robust, stable financial markets and a strong financial regulatory framework. Our work is not done yet. Further progress lies ahead, and in fact we recognize that there must be a process of continuous improvement in risk measurement and management.

* * * * *

Let me turn to address the issues that are the main focus of your hearing today.

In the past few months, the issue of extraterritoriality has become a topic of much concern to U.S. financial markets participants.

Extraterritoriality refers to the application of one jurisdiction's laws to activities conducted outside that particular jurisdiction, and to institutions operating within the jurisdiction but not based in it. It's about whether and how U.S. laws and regulations apply to non-U.S. companies doing business with non-U.S. firms, with U.S. banks and/or their non-U.S. subsidiaries. It is also about how U.S. laws and regulations apply to non-U.S. dealer firms doing business with U.S. firms and companies. Ensuring that non-U.S. firms can continue to provide new sources of capital, liquidity and risk management solutions for U.S. corporations and U.S. financial markets is an important consideration.

To date, there has been a lack of clarity about how the provisions of the Dodd-Frank Act, and the rules subsequently issued by the CFTC and the SEC, pertain to non-U.S. banks, foreign subsidiaries and branches of U.S. banks or U.S. subsidiaries of foreign banks.

Recently, though, U.S. Federal banking regulators issued rules on margin requirements that included provisions regarding extraterritorial application of the margin requirements, at least for swap dealers subject to prudential regulation. These rules appear to apply the margin requirements just to the U.S. activities of a non-U.S. swap dealer with a foreign parent on the one hand but to the global activities of a non-U.S. swap dealer with a U.S. parent on the other. By subjecting the non-U.S. activities of non-U.S. swap dealers of American banks to the margin requirements, these proposed rules potentially establish a framework that would create significant competitive issues for swap dealers affiliated with American holding companies.

U.S. banks are global in nature. Large components of their businesses are based in foreign countries and generally operated through subsidiaries or branches. If the framework described above for margin rules were to be adopted more broadly by U.S. regulators that could create serious issues for U.S. competitiveness. For instance, if derivative transactions between an Italian company and the UK subsidiary of an American bank were subjected to transaction level Dodd-Frank rules, such as margin rules or rules requiring clearing or electronic execution, but similar transactions between that German company and a UK bank without a U.S. parent were not subject to those same rules, the end result would be that foreign companies would avoid doing business with swaps dealers affiliated with American companies. They would instead transact with non-U.S. financial institutions not covered by the scope of these margin requirements. It could put U.S. firms at a serious competitive disadvantage.

The extraterritoriality proposals are inconsistent with Congressional intent regarding the territorial scope of the new regulatory framework for derivatives. The Congress included provisions in Dodd-Frank that explicitly instruct regulators to impose the regulations outside the U.S. only if there is a "direct and significant connection" with U.S. activities or commerce or as necessary to avoid evasion of Dodd-Frank. These provisions are intended to appropriately balance the protection of the safety of the financial system with the competitiveness of U.S. institutions, which is also necessary for a healthy U.S. banking system.

Similarly disadvantaging foreign institutions and U.S. subsidiaries of such institutions, through divergent capital requirements or otherwise, discourages foreign investment in U.S. subsidiaries, which leads to less jobs and to less competition within our shores. Such divergent treatment also creates the potential for retaliatory measures abroad, thus limiting opportunities for U.S. firms to grow overseas.

* * * * *

Clearly, the extraterritoriality issue is one that requires careful and thoughtful consideration amongst a country's domestic regulators, as well as regulators and policymakers across jurisdictions.

This leads me to my second point today: such deliberation is extremely difficult to achieve given the scope and pace of the regulatory reform efforts that are currently underway.

The volume of rulemakings is very large, they are complicated, and there are significant interdependencies among many of the rules. Many market participants do not yet know whether or how or when the new rules will apply to them. The scale of change required in the swaps market by the Dodd-Frank Act, including new trading, reporting and clearing requirements, registrations, compliance regimes, and documentation requirements cannot be overstated.

All of this creates a great deal of uncertainty. It may also unintentionally create competitive disadvantage for U.S. firms. The fact that U.S. firms will be subject to a new regulatory framework well before a complementary framework is established in other key jurisdictions is itself a cause for concern. The potential for that U.S. framework to inadvertently create an uneven playing field for U.S. firms adds to those concerns.

Similarly, there is a significant amount of uncertainty for the many well-regulated non-U.S. firms who are members of ISDA and who operate in U.S. markets. The prospect of complying with two sets of regulatory regimes is unprecedented and could ultimately lead to increased costs, decreased liquidity and a reduction in the overall availability of capital in the U.S. markets.

We believe the CFTC has taken a step toward addressing the need for market participants to assess the full mosaic of rules by reopening Title VII comment periods for 30 days. However, simply re-opening the comment period does not provide any insight on how the extensive prior comments on the original proposals may have influenced the Commission's thinking in crafting final rules. The comment period re-opening cannot replace the value of allowing consideration of how the over 14,000 comments in the Commission's 2011 comment file will be incorporated into the rules. In order to ensure that the substance of the final rules work efficiently as a whole, it is essential that market participants have an opportunity for additional review and comment on the entire revised set of rules which the Commissions will publish after evaluating comments received.

In addition to the need for a second or subsequent comment period on rule proposals, there is also a significant need for a rational, appropriate phase-in of implementation of the rules across markets and market participants. The former will be essential so that rules are appropriately tailored, work in tandem, and avoid unduly impairing market liquidity or adversely impacting investors. The latter is about enabling market participants to implement the changes most effectively. Both issues are, however inter-related: it is not enough to phase-in implementation if the final rules themselves are unworkable or in conflict.

As we approach the July deadline for the Commissions to finalize these mandated rules, it has become increasingly clear to market participants and the Commissions, as well as legislators, that the process will require more time than had been contemplated by Dodd-Frank. As a result, ISDA supports efforts to provide policymakers and market participants with additional time needed to weigh the individual and cumulative impact of the proposals, as well as their costs and benefits. This would help to ensure that U.S. firms are not unintentionally disadvantaged by any aspects of the proposed rulemakings.

The Commissions have the flexibility to determine the effective dates for many of their finalized rules. However, many of the significant provisions of Title VII are self-executing. That is, they become automatically effective on July 16 without rulemaking. We have developed, and have discussed with the Commissions, suggested approaches that would phase in the implementation of new rules. Our approach is based on a series of key principles that we believe should govern the implementation schedule. Our six key principles (outlined in more detail in the attached letter) are:

First, provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the markets. New market infrastructure and technologies, including central clearing services, data reporting services and trading platforms, will be required under the new swaps regulatory regime. Unless sufficient time is allotted for these components to adequately develop, all market participants (and particularly end-users) will face interruptions in their ability to access markets.

Second, swap data reporting to regulators should be the first priority for implementation in order to inform future rulemaking. The Commissions will have much visibility into all aspects of swap markets from the data collected by trade repositories. This knowledge will be essential in developing rules that meet Dodd-Frank's requirements while still allowing for active and liquid swap markets.

Third, phase-in requirements by type of market participant and asset class. We believe the Commissions should require clearing, reporting and electronic execution for the "better-prepared" asset classes first and should provide ample time for the maturation of those asset classes and products that are not yet at that stage. Better prepared assets classes would include those with an establish clearing infrastructure, such as interest rate and credit products.

Fourth, within each asset class and type of market participant, prioritize reduction of systemic risk. A principal objective of Title VII of Dodd-Frank is the reduction of systemic risk in the financial markets. As a result, the Commissions should, within each asset class and type of market participant, prioritize implementation of requirements that reduce systemic risk ahead of other requirements.

As an example, Dodd-Frank requires central clearing of swaps to decrease systemic risk, so clearing should be prioritized in the phase-in schedule. Other requirements of Title VII, such as electronic execution and public real-time reporting, should be implemented after clearing. In fact, implementing these provisions prematurely can increase systemic risk.

Fifth, allow time for adequate testing by, outreach to and education of customers and for changes to customer relationships. A flexible approach to rulemaking and implementation will provide customers the necessary opportunity to understand these ongoing changes and their own regulatory obligations.

Sixth, where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets. We believe that the Commissions and other U.S. regulatory agencies should anticipate where the rulemaking may overlap, and possibly conflict, and make every effort to actively coordinate with each other and with foreign regulators both as to harmonizing the substance of related regulations and the timing of their implementation.

* * * * *

Turning now to my third and final point: today, OTC derivatives market participants are concerned by the potentially divergent approaches being taken in key regulatory jurisdictions.

Much of the derivatives regulatory framework for the EU is still under discussion. There is a significant concern that the EU's approach could differ significantly from the U.S. regulators' approach. Requirements for the use and structure of execution platforms, capital and margin requirements, and business conduct standards, to name but a few examples, could differ substantially between regimes. It is too early to know for sure what frameworks will be adopted in the EU, but E.C. officials have indicated publicly that it is not their intention to change the structure of the OTC derivatives markets. The E.C. has not, of course, completed its rule-making process so we cannot be sure of what other differences may lie ahead. It appears, however, that the E.C. is focusing on the key systemic risk issues arising from the financial crisis that have been identified by the G20 and the Financial Stability Board—counterparty credit risk, regulatory transparency and market infrastructure.

* * * * *

In conclusion, while some differences between jurisdictions in terms of detailed rules are inevitable, a far greater degree of convergence is essential to the long-term health of the global financial system and to the relative standing of individual financial systems.

We ask policymakers to avoid introducing rules in a way that leads to a significant level of divergence between markets, or that leads to regulatory overlap or to regulatory conflict.

Each of these approaches carries significant costs. If the U.S. and the E.C. continue to take divergent approaches, the potential exists for significant differences to develop in how our markets function and operate, and ultimately in how well customer needs are met in each. This could put American firms and American markets at a disadvantage, including by discouraging continued growth and participation by non U.S. firms in American 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.*

Chairman Conaway, Ranking Member Boswell and Members of the Subcommittee: Thank you for your time today. Let me close by reiterating ISDA's support for a stronger, more robust financial regulatory framework and safer, more efficient OTC derivatives markets. I would be happy to answer any questions that you might have.

ATTACHMENT

May 4, 2011

DAVID A. STAWICK, *Secretary,*	ELIZABETH M. MURPHY, *Secretary,*

Commodity Futures Trading Commission,
Washington, D.C.;

Securities and Exchange Commission,
Washington, D.C.

Re: Phase-In Schedule for Requirements for Title VII of the Dodd-Frank Act

Dear Mr. Stawick and Ms. Murphy:

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Title VII**" of "**Dodd-Frank**") will fundamentally transform the swap and security-based swap (collectively, "**Swap**") markets. As the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**" and, together with the CFTC, the "**Commissions**") are acutely aware, Congress sketched out broad parameters of this new regulatory regime but left to the Commissions the enormous and delicate task of filling in the details through rule-making. Generally, Title VII requires the Commissions to finalize these mandated rules by July. As we approach that time, it has become increasingly clear to market participants and the Commissions, as well as legislators, that finalizing these rules will require more time than had been contemplated by Dodd-Frank. Fortunately, however, the Commissions have the flexibility to determine the effective dates for those finalized rules.

In a series of recent meetings, representatives of the Futures Industry Association (the "**FIA**"), the Financial Services Forum, the International Swaps and Derivatives Association ("**ISDA**") and the Securities Industry and Financial Markets Association ("**SIFMA**" and together, the "**Associations**")[1] have discussed with CFTC Chairman Gensler, CFTC Commissioner Sommers, CFTC Commissioner Dunn and their staffs, as well as with the SEC staff, the significant practical hurdles to implementing this new regulatory structure for Swaps, the interdependencies of the key portions of that structure and the Associations' suggested approaches to a phased-in implementation schedule. Attached are two timelines we provided to the Commissions at these meetings. In light of those discussions, and at the CFTC's request, this letter lays out key principles for the development of a phase-in schedule.

Our six key principles are:

1. **Provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the Swap markets.** New market infrastructure and technologies, including central clearing services, data reporting services and trading platforms, will be required to give effect to the new Swap regulatory regime. Unless sufficient time is allotted for these components of market infrastructure and technologies to adequately develop, all market participants (and particularly end-users) will face interruptions in their ability to enter into Swaps to hedge their business risks or manage investments to meet client objectives.

2. **Prioritize data reporting to regulators to inform future rulemaking.** The Commissions should prioritize implementation of data reporting, including registration of Swap data repositories ("**SDRs**"), to regulators ahead of real-time reporting and other requirements, including public reporting. The Commissions will learn much about the full range of Swap markets from the data collected by SDRs. This knowledge will be essential in developing rules that meet Dodd-Frank's requirements while still allowing for active and liquid Swap markets.

3. **Phase-in requirements by type of market participant and asset class.** The Commissions should phase in requirements based on the state of readiness of each particular asset class (including, where applicable, by specific products within an asset class) and market participant type. However, the Commissions should allow and encourage the development of necessary infrastructure on a voluntary basis for less-developed asset classes and any interested market participants, regardless of size, even as these requirements are being phased in on a mandatory basis for others.

4. **Within each asset class and type of market participant, prioritize reduction of systemic risk.** Within each asset class and type of market participant, the Commissions' top priority should be to implement requirements that reduce systemic risk, such as the use of centralized Swap clearinghouses. Implementation of requirements designed to achieve other goals, such as trade execution, should be phased in only once clearing has been successfully implemented. Other requirements for which SDR-collected data is crucial, such as public real-time reporting, should follow.

[1] Further information on the Associations is available in *Appendix A.*

5. **Allow time for adequate testing by, outreach to and education of customers and for changes to customer relationships.** Dealers, major Swap participants, asset managers, technology and systems providers, and the Commissions will need to engage in a concerted effort over a period of time to educate their clients and the market about the changes in business and regulatory practices that the new rules will require. The Commissions should provide adequate time for these important tasks as part of any implementation schedule.

6. **Where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets.** Application of provisions of Title VII to the diversity of Swaps and market participants will involve the interaction of rules relating to different asset classes and products as well as differences among rules imposed by different U.S. regulators and regulators in different countries. Understanding these interactions and sequencing implementation of the rules accordingly will create a more robust regulatory structure.

These principles have been informed by the experience of the firms represented by the Associations in implementing significant market reforms, including Europe's move to the Euro currency, development of new clearing systems, the implementation of MiFID I, changing capital requirements under Basel rules, equity decimalization, and the introduction of TRACE, to name a few. Our member firms' experiences in developing systems, technological connections, policies and procedures, documentation and other changes in response to these prior changes lead us to believe that the tasks involved in implementing Title VII are monumental.[2]

As we discuss further in this letter, there are significant interdependencies among many of the rules, and many market participants do not yet know whether or how the new rules will apply to them. We believe the CFTC has taken a positive step toward addressing the need for market participants to assess the full mosaic of rules by reopening Title VII comment periods for 30 days.[3] We are concerned, however, with the significant possibility that the final rules will differ substantively from the rules as proposed in ways that present, when viewed as a whole, important new issues. While these differences may not rise to the level that would require a reproposal of the rules under the Administrative Procedures Act, we nonetheless are concerned that they may merit reconsideration by market participants and the public at the time that all rules have been put in final form.

1. Provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the Swap markets.

Title VII requires the development of significant new Swap market infrastructure, including SDRs, clearinghouses and trade execution facilities. As a result of strenuous efforts in recent years, key building blocks for parts of this infrastructure exist for certain asset classes of Swaps. However, even this existing infrastructure will need to be significantly changed in response to the Title VII and the Commissions' final rules. For example, existing data repositories will need to update their data fields to conform to requirements in the final rules, and existing Swap clearinghouses will need to make significant modifications to their models to comply with rules regarding the protection of customer collateral. Title VII will also require the development of entirely new trading platforms, such as Swap execution facilities.

In addition, Title VII requires enormous changes to the business operations of market participants. Swap dealers and major Swap participants ("**Swap Entities**") will need to conform their reporting, clearing and trading processes to the final rules, as well as comply with complex rules relating to position limits, documentation and record-keeping. These requirements will affect the compliance, legal, technology, front-office, trading desk, human resources and other departments within Swap Entities. While some Swap Entities have begun to organize themselves for im-

[2] Although not all rules have yet been proposed, it is essential to address implementation sequencing and phase-in schedules now. It is worth noting, however, that we and our members are also still focused on many critical issues raised by Title VII and the rules proposed by the Commissions so far. These include, by way of example, key definitions, extraterritorial application, segregation requirements for customer collateral, margin and capital requirements, and achieving consistency, to the extent appropriate, between the rules of the two Commissions and those of international regulators. We will continue to participate in the public rulemaking process with respect to these and other issues, even as we suggest appropriate implementation timing for those rules.

[3] *Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FED. REG. 25274 (May 4, 2011) (extending comment period for rule makings until June 3, 2011).

plementation of Title VII, such efforts are very preliminary as no rules have been finalized. The Commissions must provide sufficient time for all of these steps to proceed in an orderly manner. The amount of time this will take is highly dependent on the final form of the rules. In particular, if existing systems are not easily adaptable to the Commissions' ultimate requirements, more time will be needed.[4] Clients will similarly need to make significant modifications to their businesses, including changes to the documentation that governs their relationships with Swap Entities. In many cases, these changes may require board authorization. Since boards may only meet periodically, this may result in further delay.

These two types of changes—market infrastructure and business practices—are interdependent. In the area of clearing, for example, Swap clearinghouses will need to develop rules that meet the Commissions' requirements and obtain requisite approval of those rules. Potential clearing members will need to understand the new rules put into place by each Swap clearinghouse, determine which Swap clearinghouses to join as clearing members, negotiate appropriate documentation, set up technological connections and develop clearing offerings for their clients. Non-members, including many buy-side firms, will need to understand the rules put into place by each Swap clearinghouse, determine which Swap clearinghouses they are comfortable with, evaluate which Swap clearinghouses clear certain products, choose clearing members to clear through, negotiate documentation with clearing members, and create any necessary technological connections with clearing members. Legal documentation, treatment of collateral, margin requirements, account setup, and fee negotiations, for example, between the Swap clearinghouses and their clearing members will take significant time.

In addition, the amount of time it will take to implement this infrastructure is highly dependent on market readiness. All end-users will need to clear their trades at a limited number of Swap clearinghouses through a limited number of dealers offering clearing services. If the Commissions do not provide sufficient time for this to occur, bottlenecks are sure to develop, with asset managers, for example, unable to process accounts at Swap clearinghouses overwhelmed with an influx of documentation and applications. The result will be disruption of trading as these money managers, or similar entities, will be unable to enter into Swaps that they legally would be required to clear but operationally cannot.

Allowing sufficient time for infrastructure and business practices to develop will save unnecessary costs. For example, under Title VII, SDRs will be required to accept universal, unique identifiers for Swap market participants and products, and market participants will be required to incorporate these unique identifiers into their reporting systems. Systems will be more efficiently designed and implemented if universal identifiers are developed and instituted prior to the new SDR reporting requirements. The alternative would require Swap Entities to redesign reporting systems when unique identifiers were later required.

2. Swap data reporting to regulators should be the first priority for implementation in order to inform future rulemaking.

SDR reporting to regulators will significantly increase, in the near term, the information that the Commissions have at their disposal regarding the Swap markets. Armed with a larger set of data, the Commissions will be in a better position to adopt rules that achieve Dodd-Frank's goals while maintaining active and viable Swap markets. As a result, the Commissions should delay finalizing requirements that could benefit from the additional knowledge gained from this data until SDRs have been established and are operational, and enough time has passed to allow sufficient data collection and analysis.[5]

For example, we believe that the rules defining block trades are extremely important and will have a significant impact on the liquidity of the Swap markets. Appropriate block trade thresholds, and therefore public real-time reporting requirements,

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[4] Beyond this, the Title VII rules and other financial reform changes (such as the Basel III regulatory capital standards) are causing Swap Entities and the organizations of which they are a part to evaluate the corporate structures that will enable them to provide the highest degree of service and continuity to clients while effectively managing risk. Adapting such structures requires additional independent systems, compliance and documentation implications.

[5] To maximize the effectiveness of information gathered across asset classes from SDR recordation, the Commissions should strive to harmonize their reporting requirements. Inconsistencies between the CFTC and SEC reporting requirements will significantly complicate implementation because swaps and security-based swaps are transacted by the same business units of our member firms. For example, the same business unit may trade both single-name CDS, which would be subject to the SEC's reporting rules, and index CDS, which would be subject to the CFTC's. In addition, the Commissions should strive to align their reporting requirements with those of international regulators.

can only be set after SDR reporting to regulators has been established and Swap market transaction data is carefully analyzed.[6] Any determination of block trade thresholds before that market data is available to regulators would be inappropriate. Once the relevant information has been collected, the Commissions should begin phasing in real-time reporting requirements slowly, beginning with low block trade thresholds, and adjust the thresholds as necessary once the impact on the market can be assessed.

In the interim, in order to provide the public transparency anticipated by Dodd-Frank without risking significantly decreased liquidity, the Commissions could require end of day reporting of Swap notional size to regulators early in the implementation schedule, provided that all trades above a certain notional threshold would be reported as "$X or above." After more is known about the Swap markets through data collection by SDRs, the thresholds could be adjusted slowly while the effect on market liquidity is studied.

Similarly, it is important for the Commissions to understand the Swap markets, through analytical data analysis, before adopting commodity position limits that restrict the Swap positions market participants can take. Otherwise, the Commissions might unwittingly set commodity position limits so low as to disallow legitimate and desirable activity and inadvertently decrease liquidity, thereby negatively impacting pricing.

3. Phase-in requirements by type of market participant and asset class.

The term "Swap" encompasses a wide variety of products in a wide variety of asset classes. These products have different attributes, including differing levels of standardization, liquidity and existing market infrastructure. As a result, some products are more ready for centralized clearing and electronic execution than others. For example, certain commodity and interest rate products are already quite liquid and standardized and have been subject to inter-dealer clearing for several years. On the other hand, certain foreign exchange, credit and equity Swaps are less standardized and are generally transacted bilaterally. We believe that the Commissions should require clearing, reporting and electronic execution for the "better-prepared" asset classes first and should provide ample time for the maturation of those asset classes and products that are not yet at that stage.

Sequencing that reflects these differences would allow the Commissions and market participants to understand and solve the problems that arise in these relatively less complex, more liquid products before moving on to more complex, less liquid products. For example, issues relating to client clearing can be more readily worked out in the interest rate swap market where inter-dealer clearing already exists; lessons learned there can then be applied to the clearing of other Swap categories, which will require new clearing methodologies even for the inter-dealer market.

In addition, the Commissions' rules under Title VII will affect a wide variety of market participants, ranging from market makers, to financial end-users that use Swaps for portfolio risk-management purposes, to commercial enterprises that use Swaps to hedge business risks. These market participants vary dramatically in their resources, market sophistication and rationale for using Swaps. Swap Entities, in general, have greater resources, access to technology and clearing infrastructure than their end-user counterparties. Consequently, the inter-dealer market, which already uses central clearing extensively for interest rate and credit products, may be able to adjust more quickly than some other markets to new Title VII requirements.

Much like phased implementation by product, phased implementation by type of market participant will allow the Commissions and market participants to use lessons learned from larger market participants when developing rules applicable to end-users. For example, inter-dealer clearing within each asset class should be required before customer clearing, so that the lessons learned from the inter-dealer experience can be applied to customers before the additional complications that customer clearing brings, such as the protection of customer collateral, are fully tackled. This is not to say that the customer clearing systems should not be built in parallel; the Commissions should encourage a move to Title VII-compliant activity across all market participants and products and market participants should be permitted to clear prior to the required dates if they are ready and willing to do so. However, the Commissions, for example, should not *require* clearing by any end-users until the inter-dealer experience within each asset class is well-established and understood.

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[6] The CFTC has proposed a two-part test for determining the block trade threshold, which is highly dependent on data about swap transactions. Because SDR reporting will increase the amount of information available to the Commissions across various markets and asset classes, we believe such a rule is premature and should not be adopted absent further data.

4. Within each asset class and type of market participant, prioritize reduction of systemic risk.

A principal objective of Title VII of Dodd-Frank is the reduction of systemic risk in the financial markets. As a result, the Commissions should, within each asset class and type of market participant, prioritize implementation of requirements that reduce systemic risk ahead of other requirements.

As an example, Dodd-Frank requires central clearing of Swaps to decrease systemic risk. As a result, clearing should be prioritized in the phase-in schedule. In contrast, other requirements of Title VII, such as electronic execution and public real-time reporting, should be implemented after clearing. In fact, implementing these provisions prematurely can increase systemic risk. For example, implementing mandatory trade execution with overly narrow block exceptions that have not been informed by a sufficient amount of analytical data could significantly decrease Swap market liquidity, making it more difficult for end-users to manage their risks and potentially adding risk to the financial system.

However, even systemic risk-reducing changes must be done carefully; simultaneous changes could lead to errors that unintentionally result in increased and concentrated systemic risks. For example, while central clearing has the potential to significantly reduce systemic risk, the fact that a clearinghouse is the counterparty to all Swaps it clears means that, if clearinghouse risk management and control processes are not sufficiently robust, systemic risk could increase in a cleared environment rather than decrease. As discussed above, the Commissions should strive to minimize such unintended consequences by sequencing effectiveness of requirements with ample time for thoughtful and careful implementation supported by sufficient analytical data.

The existence of a robust set of cleared swaps is also a prerequisite for implementation of margin requirements. Initial margin requirements will be significantly higher for noncleared Swaps (proposed to cover 99% of movements over a 10 day window) than for cleared Swaps (which generally seek to cover 95% or 99% of movements over a 3–5 day range). Implementing these margin requirements for noncleared Swaps before Swap clearinghouses are operational would force market participants to post inappropriately high levels of margin to enter into Swaps that they would otherwise be interested in clearing.

5. Allow time for adequate education of customers and for modifications to customer relationships, including documentation.

Dealers, major Swap participants, asset managers and the Commissions will need to engage in a concerted effort over a period of time to assist customers and other market participants in understanding the changes in business and regulatory practices that the new rules will require. Furthermore, key market practices will further evolve as new market infrastructure is put into place. A flexible approach to rulemaking and implementation will provide customers the necessary opportunity to understand these ongoing changes and their own regulatory obligations.

For example, while dealers and asset managers have been anticipating Title VII's changes in regulatory structure, they will face an enormous task of educating their clients that can only commence once final rules are known and forms of documentation are finalized. These entities may have thousands of clients with a wide range of sophistication. For example, asset manager clients include pension funds and other tax exempt entities. Dealers and asset managers will each play a role in helping inform their clients not only about Title VII and the Commissions' rules, but about the rules and changes to their transactions that will result from the use of new clearinghouses, trade execution platforms and SDRs.

6. Where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets.

Swap businesses will, in many cases, be subject to regulation by both Commissions. Infrastructure providers and market participants will need to develop systems and procedures to comply with rules from both Commissions. To the extent there are substantively different rules applied by the two Commissions, implementation and compliance systems will need to be designed to track and account for these differences.

In addition, given the global nature of today's financial markets, it is unclear to what extent foreign regulation, in addition to regulation by the Commissions, may affect U.S. Swap market participants. In each case, it would be premature to implement any requirements where there remains uncertainty as to other potentially applicable requirements. For example, it is uncertain what would happen if one of the

Commissions and its foreign counterpart both required that the same transaction be cleared but did not have common permitted clearinghouses.

We believe that the Commissions and other U.S. regulatory agencies should anticipate where the rulemaking may overlap, and possibly conflict, and make every effort to actively coordinate with each other and with foreign regulators both as to harmonizing the substance of related regulations and the timing of their implementation. Otherwise, the development of the Swap markets will be vulnerable to false starts, significant revisions and inefficiencies, and possible regulatory arbitrage across, or the flight to, other jurisdictions.

The Associations are grateful for the opportunity to comment to the Commissions regarding these important issues. Please feel free to contact the Associations should you wish to discuss this letter.

Sincerely,

Financial Services Forum;
Futures Industry Association;
International Swaps and Derivatives Association;
Securities Industry and Financial Markets Association.

CC:

Hon. GARY GENSLER, *Chairman;*
Hon. BART CHILTON, *Commissioner;*
Hon. MICHAEL DUNN, *Commissioner;*
Hon. SCOTT O'MALIA, *Commissioner;*
Hon. JILL E. SOMMERS, *Commissioner;*
Commodity Futures Trading Commission.

Hon. MARY L. SCHAPIRO, *Chairman;*
Hon. LUIS A. AGUILAR, *Commissioner;*
Hon. KATHLEEN L. CASEY, *Commissioner;*
Hon. TROY A. PAREDES, *Commissioner;*
Hon. ELISSE B. WALTER, *Commissioner;*
Securities and Exchange Commission.

Credit

	T1	T2	T3	T4	T5	T6	T7	T8	T9
Clearing	Commence Registration of DCOs		Interdealer & MSP Clearing	Initiate FEU Clearing				FEU and CEU Clearing	
Execution	Commence Registration of SEFs			Interdealer & MSP SEF Execution			Initiate FEU SEF Execution		FEU and CEU SEF Execution
Data Reporting to SDR	Commence Registration of SDRs	Interdealer reporting to DTCC warehouse		Interdealer, MSP & FEU Reporting to SDR (EOD)		Interdealer & MSP reporting to SDR (Real Time)		FEU and CEU Reporting to SDR (Real Time)	
Public Real Time Reporting	Commence Block Trade Study				Interdealer, MSP & FEU RTR to public (RTR = EOD)				All Trades RTR to Public (RTR = Real Time)
Capital & Margin	Commence Registration of SDs and MSPs								Capital & Margin Rules Finalized
Business Conduct Standards						Initiate Business Conduct Standards			Finalize Business Conduct Standards

Key:

FEU = Financial End User
SDR = Swap Data Repository
CEU = Corporate End User
EOD = End of Day
RTR = Real Time Reporting

➢ The sequencing is illustrative and for discussion purposes only; it is dependent on many yet unsettled factors, including, but not limited, to the substance of final rules. The charts were prepared by the Associations in response to a request for discussions on approaches to phasing-in of implementation, not a specific timetable for implementation.

Interest Rates

	T1	T2	T3	T4	T5	T6	T7	T8	T9	T10
Clearing	Commence Registration of DCOs				Interdealer & MSP Clearing	Initiate FEU Clearing			FEU and CEU Clearing	
Execution	Commence Registration of SEFs					Interdealer & MSP SEF Execution		Initiate FEU SEF Execution		FEU and CEU SEF Execution
Data Reporting to SDR	Commence Registration of SDRs			Interdealer, MSP & FEU Reporting to SDR (EOD)			Interdealer & MSP reporting to SDR (Real Time)			All FEU and CEU reporting to SDR (Real Time)
Public Real Time Reporting	Commence Block Trade Study				Interdealer, MSP & FEU RTR to public (RTR = EOD)					All trades RTR to public (RTR = Real Time)
Capital & Margin	Commence Registration of SDs and MSPs									Capital & Margin Rules Finalized
Business Conduct Standards						Initiate Business Conduct Standards			Finalize Business Conduct Standards	

Key:

FEU = Financial End User
SDR = Swap Data Repository
CEU = Corporate End User
EOD = End of Day
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➢ The sequencing is illustrative and for discussion purposes only; it is dependent on many yet unsettled factors, including, but not limited, to the substance of final rules. The charts were prepared by the Associations in response to a request for discussions on approaches to phasing-in of implementation, not a specific timetable for implementation.

APPENDIX A

FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets. For more information, visit *www.futuresindustry.org*.

The Financial Services Forum is a non-partisan financial and economic policy organization comprising the CEOs of 20 of the largest and most diversified financial services institutions doing business in the United States. The purpose of the Forum is to pursue policies that encourage savings and investment, promote an open and competitive global marketplace, and ensure the opportunity of people everywhere to participate fully and productively in the 21st-century global economy.

ISDA was chartered in 1985 and has over 800 member institutions from 54 countries on six continents. Our members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end-users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities. For more information, visit *www.isda.org*.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit *www.sifma.org*.

Mr. NEUGEBAUER. Thank you. And now Mr. Thompson.

STATEMENT OF LARRY E. THOMPSON, MANAGING DIRECTOR AND GENERAL COUNSEL, THE DEPOSITORY TRUST & CLEARING CORPORATION, NEW YORK, NY

Mr. THOMPSON. Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, I am Larry Thompson, the General Counsel of The Depository Trust & Clearing Corporation, DTCC, a participant owned and governed utility that in 2010 settled approximately $1.7 quadrillion in securities transactions.

Since 2006, DTCC has developed a Trade Information Warehouse, a global electronic database that has virtually all position data on credit default swaps constituting approximately 2.3 million contracts from around the world with a notional value of $29 trillion. We share Congress's goal of ensuring more transparent markets, global regulatory oversight, and systemic risk mitigation. Today I would like to make three points.

First, transparent access to comprehensive consolidated market data for all regulators is the key to mitigate systemic risk in the global swaps markets. Second, providing transparency must be a cooperative effort among global regulators. Finally, the indemnification provisions in Dodd-Frank could negatively impact global market transparency and regulatory harmonization.

With respect to our first point, last year market participants and regulators worldwide agreed on a more structured and harmonized approach to the reporting and disclosure of this data under the auspices of the OTC Derivatives Regulators' Forum which is comprised of nearly 50 regulators and other authorities worldwide including all of the major regulators and central banks in the U.S. and in Europe.

The Warehouse provides regulators a model for how comprehensive global CDS data can be made available to offer greater transparency and more effective management of systemic risk. Aggregated market data is among the information now available to global regulators through the Warehouse's direct online portal. This information is available to regulators to review through either standard or customized reports to make the regulatory oversight role more robust and efficient. Today, over 25 regulators around the world have registered and are active on the portal.

Our second point highlights the importance of global regulatory cooperation. The creation of an integrated warehouse of CDS data was only possible because of such cooperation. Going forward, it is an absolute necessity that the United States, the European Union and other major global markets align their regulatory regimes to limit arbitrage opportunities that distort markets.

If the result of the global regulatory process does not ensure regulatory cooperation, data will be fragmented inevitably resulting in misleading reporting of exposures, uncertain risk concentration reports, and a decreased ability to identify systemic risk for both the regulators and marketplace generally.

Last and most importantly, DTCC remains deeply concerned about the indemnification provisions of Dodd-Frank, which require that depositories obtain indemnification from foreign regulators before sharing information. We believe that this provision which was entered into the legislation late in the process without hearings or discussion will significantly impede global regulatory cooperation. The indemnity requirement creates the unintended consequence of giving foreign jurisdiction an incentive to create local repositories in order to avoid indemnification.

Proliferation of local repositories around the world would make it difficult to obtain aggregated data for any particular asset class which in turn will impair market and regulatory oversight, create inconsistencies in the data, frustrate data analysis, and increase systemic risk. In addition, foreign regulators appear unlikely or unable to grant repositories indemnification in exchange for access to information.

DTCC encourages thoughtful solutions to the potential negative consequences of the existing indemnification requirement. Risk mitigation is central to our mission. DTCC has a unique perspective to share and appreciates the opportunity to testify before you today. I look forward to answering any questions that the Subcommittee may have. Thank you.

[The prepared statement of Mr. Thompson follows:]

PREPARED STATEMENT OF LARRY E. THOMPSON, MANAGING DIRECTOR AND GENERAL COUNSEL, THE DEPOSITORY TRUST & CLEARING CORPORATION, NEW YORK, NY

Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee:

My name is Larry Thompson. I am General Counsel of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is a participant-owned and governed "utility" supporting the financial services industry. 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 and mortgage-backed securities and money market instruments, mutual funds and annuities. It also provides services for a significant portion of the global over-the-counter ("OTC") derivatives market. To give you some idea of the magnitude of DTCC's involvement in U.S. capital markets, in 2010, the Depository Trust Company ("DTC") settled more than $1.66 quadrillion in securities transactions.

Since 2003, DTCC has been working with financial market participants and with regulators—our two core constituencies—to automate the trade confirmation process for credit default swaps ("CDS"), essentially replacing a manual error-prone process, where only 15% of all CDS trades were matched, with a process whereby virtually all CDS trades are matched through an automated system provided by DTCC.

The result of that effort was DTCC's move in 2006 to create the Trade Information Warehouse ("TIW" or "Warehouse"). The Warehouse is a centralized, comprehensive global electronic data repository containing detailed trade information for the global CDS markets. The TIW database currently represents about 98% of all credit derivative transactions in the global marketplace. It holds approximately 2.3 million separate contracts with a gross total notional value of $29 trillion and has operations in both the U.S. and the European Union.

I appreciate the opportunity to share DTCC's thoughts on the harmonization of global derivatives reform. In particular, my comments today will focus on issues raised by the Dodd-Frank Act's creation of a swap data repository ("SDR") system and the international framework for information data sharing and connectivity among these repositories.

Based on our experience in constructing and managing the world's first and most comprehensive global derivatives repository, DTCC is convinced that a properly constructed SDR system will play a fundamental role to promote more transparent markets for global regulatory oversight and systemic risk mitigation, protect the public and help ensure liquid and efficient capital markets.

Summary of Critical Points

DTCC will highlight three points on harmonizing global derivative reform that focus on the Subcommittee's key agenda items today. Each point has a fundamental impact on U.S., and global, market competitiveness:

1. Transparent Access to Comprehensive, Consolidated Market Data for All Regulators is the Key to Any Attempt to Mitigate Systemic Risk in the Global Swap Markets

It is critical that regulators worldwide be able to access the core infrastructure and consolidated asset class databases to protect against the build up of systemic risk.

Last year, market participants and regulators worldwide agreed on a more structured and harmonized approach to the reporting and disclosure of this data under the auspices of the OTC Derivatives Regulators' Forum ("ODRF"). ODRF is comprised of nearly 50 regulators and other authorities worldwide including all of the major regulators and central banks in the U.S. and Europe. Today, through the development of the Warehouse, DTCC offers these regulators a model for how a comprehensive global CDS data set can be made available to offer greater transparency and more effective management of systemic risk. This model was designed by DTCC with direct input from global regulators through the cooperative efforts of the ODRF, with over 1,700 participants in the CDS market from over 50 member countries.

The Warehouse provides comprehensive standard position risk reports to appropriate authorities worldwide (as well as responding to over 100 ad hoc requests from such authorities last year). DTCC recently launched an automated portal to provide regulators worldwide with direct, on-line access to global CDS data registered in the TIW. The information available in the portal is precisely the aggregated, current, accurate information that regulators need to monitor and identify systemic risks to the financial markets, across jurisdictions.

Over 25 regulators around the world have registered and are active on the portal. This is the first such global regulatory service of its kind in the financial market place. The portal allows for each registered regulator to access reports tailored to their specific entitlements as a market regulator, prudential or primary supervisor, or central bank. These detailed reports are created for each regulator to show only the CDS data relevant to the individual regulator's jurisdiction, regulated entities or currency.

As an example, had the CDS Warehouse system for reporting and disclosure of data created through these cooperative efforts been operational in 2008, and applied over the complete global data set subsequently created, regulators would have had consolidated data and aggregate risk concentrations sufficient to have had an early warning of the build-up of American International Group's positions.

To ensure that consolidated asset class data remains readily available for regulators and provides the information needed to make decisions about future entities, which acquire positions that are systemically risky, it is vital that rules are put in place that are consistent between jurisdictions. Equally as important, these rules must be implemented in such a way that ensures a consistent implementation time frame among jurisdictions to prevent potential arbitrage in inconsistent application of repository rules.

For CDS, the comprehensive global market information that DTCC is now able to publish includes, among other things, net market-wide exposures to each CDS index and index tranche, as well as market-wide exposures to each of the top 1,000 individual corporate and governmental entities on which CDS are written (top 1,000 ranked by size of exposure). This allows market participants, regulators and the public to assess risks, in real-time, on the basis of comprehensive data to enable them to develop much more informed views. The published data also indicates which broad category of market participants holds what positions in relation to important areas of the market, such as overall exposure to sovereign debt, corporate debt and other broad categories, although not in such detail as would threaten to disclose the identity of position holders.

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, might have been mitigated.

2. Providing Transparency is a Cooperative Effort Among Global Regulators

The creation of an integrated warehouse of CDS data would not have been possible without the substantial and unprecedented degree of global regulatory cooperation achieved through the ODRF and the OTC Derivatives Regulators Supervisors Group ("ODSG").

This process worked because the entity operating the repository, in this case DTCC, is not a traditional commercial entity. By removing commercial concerns from what is and should remain primarily a regulatory and supervisory utility support function, the Warehouse was to able provide a central place for data to be reported and for regulators to access it *for both market surveillance and risk surveillance purposes,* simultaneously helping both the regulators and market participants.

DTCC believes it is an absolute necessity that the United States, the European Union and the other major global markets align their regulatory regimes to limit arbitrage opportunities that distort markets. As the Securities and Exchange Commission ("SEC") and Commodity Futures Trading Commission ("CFTC") continue to work through the Dodd-Frank Act rulemaking process, DTCC urges both Commissions, in their regulation of SDRs, to aim for regulatory comity as has already been achieved by the ODRF and as may be further agreed to by such other international bodies as the Committee on Payment and Settlement Systems ("CPSS") and the International Organization of Securities Commission ("IOSCO").

As an industry-governed utility, with buy-side firms, sell-side firms and self-regulatory organizations as stakeholders, DTCC has been able to secure the cooperation of all relevant market participants, clearers, and trading platforms with any significant volume. This comprehensive base has made the Warehouse effective.

As discussed at the recent SEC–CFTC joint roundtable on Dodd-Frank implementation, even representatives of buy-side firms recognize the importance for consolidated reporting of swap information to a central location for systemic risk oversight purposes over the life of a transaction. Participants from firms such as Loomis, Sayles & Company and The Vanguard Group, who represent investors around the world, have encouraged regulators to adopt globally consistent rules.

The global SDR framework which emerges from the Dodd-Frank and European regulatory processes must ensure that this kind of comprehensive data, as maintained in the Warehouse for all derivatives markets on a global basis, is expanded.

If the result of the global regulatory process does not ensure regulatory cooperation or the cooperation of market participants and their respective clearers and trading platforms, both the published and regulator-only accessible data would be fragmented, inevitably resulting in misleading reporting of exposures, uncertain risk concentration reports and a decreased ability to identify systemic risk for both the regulators and the marketplace generally.

Fragmentation of data—either by asset class or jurisdiction—would leave to regulators the task of rebuilding in multiple instances the complex data aggregation and reporting mechanisms (including extra-territorial trades on locally relevant underlyings). That task was one of the primary reasons that the industry and regulators themselves created a single place for the CDS data within the TIW.

An important issue that U.S. and global regulators need to address, particularly as the implementation of the Dodd-Frank Act results in the growth of SDRs globally, is how to best handle data collected by an SDR where the trade would not be reportable to U.S. regulators under the statute, by virtue of where it took place or the counterparties involved.

In this regard, DTCC points to the guidance in a letter from the ODRF membership [1] related to global regulator access to TIW data.[2] The ODRF letter contemplates a U.S. regulator (SEC or CFTC) receiving data from the TIW that goes beyond the scope of information proposed by the Dodd-Frank Act or the agencies' proposed rules, such as data related to overseas transactions entered into by non-U.S. persons on U.S. underlyings. Today, the TIW routinely provides this transaction data to U.S. regulators (and conversely, routinely provides data related to transactions in the U.S. by U.S. persons on European underlyings to European regulators), as contemplated by the ODRF regulatory standards. This spirit of cooperation and coordination between regulators around the world must be preserved and expanded. Without such cooperation, the SEC's or CFTC's ability to routinely receive details of purely European transactions written on U.S. underlyings would be frustrated.

The role of aggregating SDR information is critical in that it ensures regulators have efficient, streamlined access to consolidated data, reducing the strain on limited agency resources. International financial regulators have identified this approach as a valuable one, noting that:

> "Authorities should ensure that [SDRs] are established that provide aggregate global coverage of the global derivatives market and that the *data collected can be aggregated so as to provide a comprehensive view of the market.* The establishment of uniform data standards and functional requirements for data exchange will be a necessary condition for authorities to have a timely and consistent global view for assessing and analyzing the OTC derivatives markets. *One beneficial solution would be to establish a single global data source to aggregate the information from [SDRs]* [emphasis added]." [3]

Aggregated market data is among the information now available to global regulators through the Warehouse's direct, on-line portal. This information is available for regulators to review through either standard or customized reports to make the regulatory oversight role more robust and efficient.

The challenge going forward is to bring similar regulatory and public transparency to other parts of the swap markets.[4] Given the need to move expeditiously and to assure the continuation of the necessary cooperative attitude among multiple regulators, market participants, clearinghouses and trading platforms worldwide, DTCC urges that regulatory focus be on expanding the existing cooperative achievements of providing both regulatory and public transparency to the swap markets. Such cooperative efforts take some minimal amount of time to implement safely and soundly (experience suggests a minimum of 24–36 weeks if all participants cooperate). If there is a lack of cooperation, it could take significantly longer.

As a user governed and regulated utility servicing most of the major regulators worldwide, DTCC believes that market participants and regulators are poised to undertake the significant cooperative effort necessary to provide complete transparency to these markets as contemplated by the Dodd-Frank Act.

DTCC encourages the Subcommittee, in exercising its oversight responsibilities, to focus on removing obstacles to this regulatory process and to continue to use proven infrastructure in a manner that distinguishes the SDR function from purely commercial considerations and jurisdictional quarrels, which could hinder the cooperative attitude that has made progress possible thus far.

3. The Indemnification Provision in the Dodd-Frank Act Could Negatively Impact Global Market Transparency and Regulatory Harmonization

Consistent with the need for global regulatory cooperation in ensuring access to the data necessary to protect against systemic risk, DTCC is deeply concerned about the indemnification requirements in the data security provisions of Sections 728 and

[1] Authorities Currently Involved in the OTC Derivatives Regulators' Forum. Available at: *http://www.otcdrf.org/about/members.htm*.

[2] *See* letter from OTC Derivatives Regulators' Forum to the Warehouse Trust Company, dated June 18, 2010. Available at: *http://www.dtcc.com/downloads/legal/imp__notices/2010/derivserv/tiw044.zip*.

[3] Financial Stability Board, *Implementing OTC Derivatives Market Reforms.* October 25, 2010. Available at: *http://www.financialstabilityboard.org/publications/r__101025.pdf*.

[4] There are two other global swap repositories in existence today, one for OTC equity derivatives operated by DTCC in London and one for OTC interest rate derivatives operated by TriOptima in Sweden. These repositories, however, were designed solely as a means to facilitate certain high-level position reporting by the major global dealers and do not hold sufficient data to meet the regulatory needs specified by either the Dodd-Frank Act or the ODRF (including both market surveillance and risk surveillance), which have superseded the initial requirements set forth for these entities.

763 of the Dodd-Frank Act, and DTCC has expressed these concerns throughout the regulatory process.

The Dodd-Frank Act requires that repositories obtain indemnifications from foreign regulators before sharing information. There was no legislative history behind this provision, which was incorporated very late in the legislative process, nor was the indemnification requirement considered in the hearing process. The resulting language was not subject to the necessary extensive discussion and consideration prior to the enactment of the Dodd-Frank Act, and its negative ramifications were not made clear. DTCC believes that the indemnification provision will significantly impede global regulatory cooperation.

The indemnity requirement creates the unintended consequence of giving foreign jurisdictions an incentive to create local repositories in order to avoid indemnification. Proliferation of local "national" repositories around the world would make it very difficult to obtain aggregated data for any particular asset class, impair market and regulatory oversight, create inconsistencies in data, frustrate data analysis and increase systemic risk.

Foreign regulators appear unlikely or unable to grant DCOs or SDRs indemnification in exchange for access to information. Accordingly, regulators may be less willing to access the aggregated market data or establish the development of local repositories, resulting in a reduction of information consumption, domestically and internationally, which jeopardizes market stability.

Perhaps unsurprisingly, the European Parliament is poised to adopt retaliatory legislation this week (24th May) as part of the European Commission's proposed Regulation on 'OTC Derivatives, clearing houses and trade repositories,' known as "EMIR" (European Market Infrastructure Regulation). Should this amendment survive the "trialogue"[5] process, U.S. regulators, like the CFTC and the SEC, will be required to indemnify EU SDRs and EU regulators in order to access data held in EU-based repositories (*e.g.,* equity derivatives and interest rates repositories).

The underlying legislative intent of the Dodd-Frank Act could therefore be subverted by the legislative language, preventing the exchange of information between regulators and frustrating efforts to identify and mitigate international financial risk and fragment regulatory oversight on a jurisdiction-by-jurisdiction basis.

DTCC encourages thoughtful solutions to the potential negative consequences of the existing indemnification requirement. While "technical correction" legislation would surely deal with this issue, given the pace at which swap data repositories will advance over the next several months around the world and the potential for retaliatory legislation in Europe, DTCC urges the Subcommittee to consider interim ways to address this situation including, for example, recognizing regulators who operate in a manner consistent with international agreements or regulatory forums such as the ODRF, which includes maintaining the confidentiality of data. Modification to Sections 728 and 763 of the Dodd-Frank Act could include provisions that "deem" compliance with those international agreements or regulatory forums as consistent with the indemnification requirement.

The issue of indemnification has recently gotten the attention of your counterparts on the Agriculture Appropriations Subcommittee. Congressman Jack Kingston (R–GA) recently remarked on the House floor that it is uncertain whether U.S. regulators even have the legal authority to indemnify EU trade repositories. Congressman Kingston said the indemnification requirement would likely create ". . . *fragmentation and information gaps that could meaningfully harm global safety and soundness. In light of the EU calendar on indemnification, swift action to prevent the unintended consequences of this inadequately considered provision of Dodd-Frank is needed.*"

Furthermore, Members of Congress are beginning a dialogue with European legislators, indicating that concerns about the indemnification provision are being taken seriously in the U.S. and that there is recognition in the U.S. that this issue must get resolved in order to avoid the resulting fragmentation of data.

Regulatory Status of Trade Repositories—Global Cooperation

Derivatives markets are inherently cross-border, as participants in a transaction are often located in multiple jurisdictions. From the outset, DTCC has recognized that the TIW serves a *global function* and the information held by the Warehouse is relevant to regulators in many locations. DTCC believes it is important to support regulators around the world and has effectively done so since the end of 2008.

The SDR regime established under the Dodd-Frank Act must recognize the global characteristics of OTC derivatives markets. For that reason, Congress rightly di-

[5] Trialogue is the three-way negotiation on the final form of the regulation undertaken between the European Parliament, the Council of the EU and the European Commission.

rected regulators to undertake international harmonization, a requirement that should apply fully to the SDR system and individual SDRs.

DTCC has worked closely with the ODRF and agreed to criteria for the sharing of data, recognizing the need to have critical data on CDS accessible across geographic boundaries and regulatory jurisdictions. DTCC has implemented regulatory disclosure processes using those criteria and urges the same approach for other asset classes going forward.

DTCC anticipates that global regulators will increasingly recognize the overwhelming advantage of identifying risks globally from a central vantage point, thereby avoiding data fragmentation, which seriously detracts from the management of systemic risk. As the system for the use of repositories is developed internationally, it is very important for the U.S. to facilitate a result that will place U.S. regulators and foreign regulators on an equal footing in their ability to obtain information from repositories quickly and without restriction. Currently, the international perception is that there is inequality to the benefit of U.S. regulatory agencies with respect to the Dodd-Frank Act's indemnity provisions, notification and direct access. This inequality needs resolution.

To promote global market transparency, U.S. standards should be developed to be compatible with those standards still under development in other countries, meeting the needs of both U.S. and foreign regulators. Given that risks to the U.S. financial system can be impacted by transactions occurring virtually anywhere in the world, it is essential that the SEC and CFTC's final regulations create SDRs that meet the immediate needs of U.S. regulators and the long-term need of global harmonization with the requirements of regulators in Europe and other major financial markets. This will ensure that meaningful international data continues to be available to U.S. regulators.

One philosophical and pragmatic question that arises with respect to global cooperation is whether market data should be collected and held by the private sector and made available to regulators on a pro-active and as-requested basis or, alternatively, whether governments themselves should collect the data and disseminate under treaty and information-sharing agreements.

The model of each government collecting data lacks some of the efficiencies of a private sector offering. The industry solution, for cost and customer connectivity reasons, will be driven to standardization across jurisdictions and the sharing of infrastructure to the maximum extent possible. These are not inconsiderable undertakings (for example the SEC estimate of costs for industry compliance in the first year was in excess of $1 billion). This standardization and sharing of infrastructure is positive from a public policy perspective as it will also support the aggregation of data for public and regulator use.

The TIW has convincingly demonstrated that global offerings can be developed in the private sector, providing cost advantages to customers from a connectivity and common infrastructure perspective, across jurisdictions. Additionally, key to this model is a sense of international cooperation and equal footing for all regulators with respect to the data needed directly in relation to areas of their regulatory responsibility.

Repositories' Role in Promoting Transparency and Reducing Systemic Risk

By aggregating information, repositories collect and compile all relevant data in order to assure appropriate market transparency and effective monitoring of systemic risk. Global repositories have been, or are being, established for each OTC derivatives asset class, which can provide regulators in the U.S. and around the world real-time access to the data necessary to monitor and safeguard financial markets.

DTCC urges Congress, as well as regulators, to carefully consider the implications of implementing rules that result in the fragmentation of information on outstanding contracts into different repositories in different countries on different continents.

For example, fragmentation of data in multiple national repositories would mean that if German regulators have to examine a dozen different trade repositories to determine the positions of different types of credit default swap contracts that may be outstanding on German companies, they may never find all of the contracts, certainly not quickly. Contract records could be scattered across repositories in the U.S., in Europe, in Japan, in Dubai, in Hong Kong and elsewhere. Nor is it likely to be apparent to the regulators what they are looking for, since the offsets to contracts residing in one database might be residing elsewhere. A contract could easily have been written between a Swiss financial institution and an Australian financial institution on an underlying German entity, only to be sold or assigned to another party located in Brazil. Even if all of the data is eventually located, an aggregation facility is required to omit duplicate records, verify and then analyze the disparate data.

All of the information detailed in the above example is currently collected in the Warehouse globally. Data is published weekly on all of the contracts held, including a breakdown by currency. Moreover, DTCC has consistently stated that all interested regulators should have access to the data they are entitled to access. Accordingly, DTCC has made such data available as appropriate to the regulators involved in accordance with the global criteria adopted by the ODRF. All of this functional transparency will be undermined if regulators move forward with an approach that does not provide for globally consolidated data.

Global regulators need consolidated reporting across international markets. International regulatory guidance for derivatives regulation has recognized that aggregated data is vital to provide a comprehensive view of derivatives markets. For example, last October, the Financial Stability Board suggested that a beneficial solution to the needs of regulators throughout the world would be the establishment of "a single global data source to aggregate the information from [SDRs]."

A system for SDR reporting around the world should be implemented promptly—but it must contain mechanisms to facilitate prompt consolidation and to avoid fragmentation if it is be effective in providing meaningful market surveillance for regulators and risk surveillance for markets.

Importance of Unique Legal Entity Identifier ("LEI")

DTCC believes that precise and accurate identification of legal entities engaged in financial transactions is critically important to private markets and government regulation.

The need for a universal LEI is clear. The current inability of regulators to quickly, confidently and consistently identify parties to transactions across all markets hinders their ability to evaluate systemic risk and take appropriate corrective steps. Going forward, regulators will be charged with gathering data originating from markets and processing systems that are geographically dispersed, and assessing the risks to specific firms and to the financial markets more generally.

There would be significant reporting benefits to the creation of a standardized, common system to identify legal entities across geographies and markets. In the view of DTCC, the universal standardized LEI is the most effective way—it may be the only practical way—to ensure data consistency across the industry and reduce the cost of systemic risk monitoring for regulators. LEI standardization will allow regulators to conduct analyses across markets, products, and regions, identifying trends and emerging risks.

DTCC has been actively engaged with other financial industry participants and regulators in the U.S. and abroad to develop a series of proposals that have been enhanced in response to the feedback from these discussions. DTCC has also reached out to several potential collaborators that could play an important role in developing a global solution, and DTCC's Board of Directors has approved the commitment of resources toward the development of such a proposed solution.

DTCC's Avox subsidiary has nearly 10 years of experience in collecting and validating legal entity information from over 200 jurisdictions, and currently maintains a database of 800,000 legal entity records. The complexities of establishing and maintaining a database of this size are considerable, and the vast amount of knowledge and experience that DTCC can leverage to support the LEI Utility is unique in the industry.

While DTCC, a participant-owned, at-cost utility, would leverage its core competencies to collect, validate and make available the LEI record, DTCC is not itself a registration authority of an international standard identifier. DTCC has had detailed discussions with the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"). SWIFT, a trusted European-based utility, is a member-owned cooperative used by more than 9,000 banking organizations, securities institutions, and corporate customers, and regulators in 209 countries. As a global Registration Authority, SWIFT has assigned Business Identification Codes ("BICs"),[6] an International Organization for Standardization ("ISO") standard, to companies for more than 30 years while developing and refining a robust registration and maintenance process that is a cornerstone of SWIFT's operations.

During the industry consultation conducted over the past several months, the industry has decided to adopt a new standard for a new LEI, and SWIFT has been named by ISO to be the Registration Authority for that identifier, meeting industry and OFR requirements.

[6] BIC is an established International Standard (ISO 9362) used by financial entities around the world as a network address and as an LEI.

On June 3, DTCC and SWIFT will be submitting a joint response to the industry's *Global LEI: Solicitation of Interest* based on the industry's *Requirements for a Global LEI Solution,* issued earlier this month. The combination of DTCC and SWIFT would create a truly global solution responsive to the needs of global firms and regulators alike. For the heightened protection of data required to support the LEI Utility, DTCC and SWIFT can establish a governance structure that can provide the opportunity for regulators and financial institutions across jurisdictions to have input into how it is operated. DTCC's own governance offers an example of how this can be accomplished, with DTCC's Board comprised of both industry experts and non-industry members representing the interests of the public and the broader markets.

Conclusion

Generally, the Dodd-Frank Act established an appropriate framework for the further development and use of repositories in the United States and internationally. DTCC recommends that regulators work closely with their global counterparts to ensure consolidated repositories can provide accurate and timely market information. Congress must review the Dodd-Frank Act's indemnification requirement and take corrective action as the existing language prevents the Commissions from reaching a global solution. The indemnification requirement could create substantial problems for U.S. regulators by giving foreign jurisdictions the incentive to establish separate repositories that operate on a local or national basis, rather than an international standard.

International coordination and cooperation is critical to achieving the level of transparency necessary to mitigate systemic risk in swaps markets. DTCC urges that legislators and regulators focus on the use of consolidated repositories, or single repositories by asset class, to counter the risk of fragmentation. Finally, it is critical that in implementing the Dodd-Frank Act, regulators build on existing systems and processes to address the policy goals of the Act. Building on existing systems will result in the most cost-efficient, effective and immediate solutions.

As stated at the beginning of this testimony, risk mitigation is central to DTCC's mission. As regulators and legislators across the globe write the rules under which the OTC derivatives markets will operate, DTCC is actively engaged in the dialogue. DTCC has a unique perspective to share and appreciates the opportunity to testify before you today.

I look forward to answering any questions the Committee may have.

Overview of DTCC

As stated above, DTCC is a user-owned market utility. Through its subsidiaries, it provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. Government securities and mortgage-backed securities transactions and money market instruments and for many OTC derivatives transactions. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing house for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC"), which has been granted registration as a derivatives clearing organization ("DCO") by the CFTC.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Exchange Act, subject to regulation by the SEC. These three clearing agency subsidiaries are DTC, National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently supports the launch of new securities issues and IPOs and provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $36 trillion. In 2010, DTC settled more than $1.66 quadrillion in securities transactions, which is equivalent to the full value of the annual U.S. Gross Domestic Product every 3 days. NSCC provides clearance and settlement, risk management, central counterparty trade guarantee services and the netting down (reducing the total number of trade obligations that require financial settlement by an average of 98% per day) for all cash equity transactions completed by the 50+ exchanges and alternative trading platforms ("ECNs") operating in U.S. capital markets. FICC provides clearance and settlement, risk management and central counterparty trade guarantee services and netting (for most securities) in the U.S. Government securities markets and for agency-backed securities in the mortgage backed securities markets.

Thus, DTCC, through its subsidiaries, processes huge volumes of transactions—more than 30 billion a year—on an at-cost basis.

Overview of the Trade Information Warehouse

Since 2003, DTCC has been working with the industry—and with regulators—to automate the trade confirmation process for CDS, essentially replacing the manual error prone process where virtually none of the CDS trades were matched in an automated environment with a process where virtually all CDS trades are matched through a system that DTCC launched in 2004. The automated capture of initial trade details associated with a CDS contract or assignment was critical to the eventual creation of DTCC's Trade Information Warehouse.

In November 2006, at the initiative of swap market participants, DTCC expanded further to launch the TIW to operate and maintain the centralized global electronic database for virtually all position data on CDS contracts outstanding in the marketplace. Since the life cycle for CDS contracts can extend over 5 years, in 2007, DTCC "back-loaded" records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 date in which the Warehouse started collecting CDS data. As stated above, the Warehouse database currently represents about 98% of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).

In addition to repository services, which include the acceptance and dissemination of data reported by reporting counterparties, the Warehouse provides legal recordkeeping and central life cycle event processing for swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or "gold" record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' more customized CDS swap contracts, in the form of single-sided, non-legally binding or "copper" records for these transactions, to help regulators and market participants gain a more clear and complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

DTCC's Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various routine events, such as calculating payments due under contracts, bilaterally netting and settling those payments and less-common events, such as credit events, early terminations and company name changes and reorganizations, may occur, all requiring action on behalf of the parties to such CDS contracts. DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

Mr. NEUGEBAUER. Thank you. I thank the panel. Mr. Thompson uses a little footnote here. You have let the cat out of the bag because there is a bumper sticker going around America now that says, "Please don't tell Congress what comes after a trillion." You have just let them know that it is a quadrillion. Keep that a secret, would you?

Mr. THOMPSON. We will keep it a secret, Congressman.

Mr. NEUGEBAUER. Thank you. Gosh, great panel. So many questions. Mr. Damgard, one of the things I think you said is something that I completely agree with and that is that we have seen all of the pieces to the mosaic, we just haven't seen the mosaic. And, particularly the volume of rulemaking that is coming out across all of these jurisdictions. But particularly I think the point that you made was after we get all of the pieces out and we get the mosaic, let's get the art critics to come in and tell us, you know what the mosaic, whether it is what we need or not. And I don't know how you harmonize even when you are having these discussions on these various pieces of legislation that you are working on—how you harmonize with these other marketplaces whether it is the Asian markets, the European markets. This is in a piecemeal basis, where they haven't seen the finished product, do you want to explain——

Mr. DAMGARD. Or even with agencies within the United States Government. I mean, the typical number of comment letters that we write to proposed rules in a normal year is four or five and we have a lot of time to consider. And I have since the Dodd-Frank Act, I think I have signed something in the neighborhood of 35 to 40 comment letters without a lot of confidence that we have really been able to anticipate what some of the unintended consequences are going to be. And I know that the stress is just as much on the agency.

I think Chairman Gensler set up these, I called them silos, and he called me at home and said those aren't silos those are teams. But these silos are so busy with these teams grinding out proposed regs one after another they hardly have time to talk to other teams within the agency, much less talk to the teams that are writing similar rules at the SEC or coordinating with the Fed in my judgment. And I think that we are going to see an awful lot of these regs come out that are in conflict with each other.

Then you bring into consideration whether or not foreign governments are going to be marching in line with us. I mean, I love listening to Mr. Chilton. You know Mr. Chilton talks about Kevin Costner in *Field of Dreams* and if we do it then everybody else is going to come our way. I mean, Kevin Costner never played Pollyanna. This is a really, really competitive world and if other jurisdictions see opportunities to attract capital and capital does show up, they are going to take advantage of that.

I share with everyone here the concern that it is really important to get this done right, not done so quickly. And I think the idea of finding out what the Commission thinks makes the most sense before they go final with these regs. As I said in my testimony, if they would publish them in their entirety and give us 60 days which is minimal really. I mean, we did a cost-benefit analysis on just one. We did a cost-benefit analysis on account ownership and control which was sort of obscure comment and it cost us $100,000 which we didn't budget in our little nonprofit. We believe that the cost-benefit analysis on all of these things really ought to be looked at pretty seriously.

Mr. NEUGEBAUER. Well, and I have said to Mr. Gensler I think their agency ought to be doing a cost-benefit analysis, and to put that analysis out and letting people also comment on that to verify whether their assumptions are correct.

Mr. Deas, I want to move to you and I think you made a very important point and I think it is something that other people may have brought up. But when you are talking about whether I am going to have to put up margin or not, what you said is the market price is the fact that I am not putting up margin. And so I am literally paying my margin in the contract, the negotiated price for the contract.

Mr. DEAS. That is right, Congressman, and it is a price that we have negotiated and it provides certainty so that we don't have to put up, make cash payments at the end of the trading day; or even according to how these rules may operate, and depending on price movements, potentially within the trading day. And so in order to make sure that we would always be able to meet a margin call, corporate treasurers would have to hold aside more than enough cash to meet those margin calls and that is more expensive than the price that we get built into the derivative contract with the bank. And it—and we get certainty through that arrangement with the bank.

Mr. NEUGEBAUER. And quickly, Mr. O'Connor, when we are looking at the extraterritorial issues are the regulations very clear as to what the triggers are, what each jurisdiction has for market certainty? Your comments on that.

Mr. O'CONNOR. Yes. I think it is—there has to be absolute clarity between which jurisdiction has what and the main point I would make, as you know, U.S. banks have global franchises these days. A large portion of their earnings arise from overseas. And if I am a French corporation or an Italian corporation or a German corporation trading with the U.S. branch or subsidiary of a U.S.—the local London or Frankfurt branch of a U.S. bank. When I trade with that entity, the U.S. entity—my transaction would be subject to margin rules or clearing or execution on an electronic venue, but I can trade with a European bank and avoid all of that then that is where the risk is from an U.S. competitiveness point of view that those transactions might be missed. And U.S. foreign clients of U.S. banks might migrate to the overseas banks in those local jurisdictions.

Mr. NEUGEBAUER. Thank you. Mr. Kissell.

Mr. KISSELL. Thank you, Mr. Chairman, and I, too, was caught a little bit by quadrillions and so I will leave that one alone, but that was—that certainly brings about a lot of interest. I don't have, Mr. Chairman, so much a question as maybe just kind of a flowing observation that—and listening to the panelists and I do appreciate your expertise and your coming to us today. And I know we have been here for awhile and I appreciate your time. There seems to be a consensus that I didn't hear anyone say we absolutely don't need to do anything. There seems to be a consensus that we need some transparency, some reforms, and obviously there is not agreement across the board as to what that would be.

I had found through kind of a steady stream throughout a lot of our hearings that we would consistently hear that we need to be careful because the markets, and the financial problems of 2008, these markets performed well. But yet we have a situation where some of my colleagues referred to earlier that there is a lot of concern that in the functioning of the markets while the players come out okay that maybe the consumers and the price function are affected by issues more than just simple supply and demand.

So I think that what we are trying to find here is a good balance so that you guys can perform well and that the consumers can be protected. And what either Mr. Courtney or Mr. Welch referred to is trying to find that balance. And I think that is what we are looking for. One question, and when you have a large panel sometimes it is hard to pin it down to one person. A lot of you brought out certain points that need to be thought out more. Just curious if you presented those in comments to the right people and if you received any feedback that makes you think that these will be taken care of. And anybody if you got—if that is something you want to jump on that would be fine.

Mr. DAMGARD. Yes, as the President of the trade association representing the futures industry, we work very carefully with, both the Senate and House throughout the deliberations of Dodd-Frank. We weren't as successful as we wanted to be. But I would say that, I can imagine the kind of pressure that you must be in when you go home and people are paying $4.50 for gasoline. And the temptation of course is to demonize speculators, or the passive longs.

And when you stop and consider that first of all the Middle East is out there and they know—they have economists knowing exactly if gasoline or crude oil gets to be over $110 demand over here drops off. We have seen the bicycle lanes going up and down Constitution Avenue. More and more people take public transportation. All the buses now are fueled by natural gas which is relatively cheap. And this is the market at work and the role of the CFTC.

And I wish Mr. Welch was still here, the role of the CFTC is not to determine that prices should go up or that prices should go down. They are supposed to look at all the elements of the market to prevent fraud and manipulation in the market. And quite honestly they have done an excellent job. And I don't think anyone here would argue that they couldn't use more resources because they had been given a much larger mandate.

I agree with Mr. Peterson, maybe the $25,000 stipulation on entertaining foreigners ought not to have been in the Act. But I probably wouldn't put that number one. I mean, I think that some of the—some of them—the concepts of position limits while they have worked in ag because they are pretty much a domestic market, it is not clear to anyone that a position limit in the financial futures market is going to do anything. And clearly outside the United States there is no appetite for position limits.

And if you are a firm and you are a global firm and you are a bank and you are bringing customer business to an exchange 24 hours a day, and one exchange or one environment is going to impose a big fine on you if you inadvertently increase, go beyond your position limit, and there are other exchanges out there and other jurisdictions that don't have that stipulation because they think they know just exactly how to manage manipulation in other ways, then quite honestly, as I said before, capital flows.

Energy markets in London, in Dubai, in Singapore, in Hong Kong, in Sun, and Shanghai will be available to investors in the United States. And just because we call it the West Texas Intermediate, we know that the fuel, that is no longer the home of where all the fuel is coming from. It is coming from the Middle East.

Mr. KISSELL. Thank you, Mr.——

Ms. MILLER. Could I just share a little comment? You asked about have we met with some of the regulators on their proposals. We have actually in fact met with the CFTC staff and the Commissioners and they have been very generous with their time. And I think they found what was refreshing about our proposal is that we were not asking for an exemption from registration when we were dealing with U.S. customers.

But they all admitted that the tough issue was this extraterritorial impact and we are 60 days out of the rules becoming effective and I think everybody on this panel would say we need to take the time to get this right, to look at comparability of foreign country regulations and let the CFTC and the SEC leverage the resources of foreign supervisors. So I think that that is what I would like to leave you with if you don't mind.

Mr. DEAS. And if I might just add a little bit to that. I mean, ISDA has been engaged with the CFTC and the SEC throughout this process. I would echo the comments made by my panel members that they have been open to meetings. Your question, part of your question was were they listening. I think the answer is yes generally. For instance, one position we have been advocating is a phased approach to implementation so certain asset classes may be more ready than others in terms of clearing or trade depositories. And there should be phasing by types of institution as well. So dealers are probably ready to go sooner than some of the money managers, for instance, who are members of ISDA who say that they have some of the biggest money managers in the world have thousands of accounts that they have to get through the door and fully up to speed in terms of making decisions or going after clearinghouses and FCM's, getting documentation in place, *et cetera*, and they need a longer time. And I think that that is not falling on deaf ears.

Mr. THOMPSON. I would agree with all of the comments of my panel members. We have spoken to both the CFTC and the SEC as well as the Treasury about the indemnification issue along with phasing as well. And generally they agree that indemnification is a problem, but it is in the statue and they don't have the solution at this point. We need a solution.

Mrs. SCHMIDT [presiding.] Thank you. Lively testimony. I have a question for Mr. Deas. I am going to go back to the regulation at hand. One justification the prudential regulators have provided for imposing margin requirements on end-users is that it simply requires the establishment of a credit support arrangement, which they claim most end-users already have. Is this the case? And what would be the impact of a new requirement that all end-users establish CSA's?

Mr. DEAS. Well——

Mrs. SCHMIDT. We will start with you and anybody else that wants to answer it.

Mr. DEAS. Yes, well, as I mentioned, we do not post any cash margin. We do not have any credit support and access for the swap agreements we have entered into with our banks, and as I mentioned in my testimony, we operate in a world of finite limits. There is a certain amount of credit capacity that is available to us. And to use that credit capacity for this purpose, to put cash or committed credit, to hold it aside to meet a margin call would be a direct subtraction from funds that we otherwise employ in our business. And the amount of credit that we would have to hold aside to do this would be an amount that—so that—so as not to risk missing any—a margin all, defaulting on a margin call. It would—we would be very conservative about that. So it would take away capital from employment elsewhere in our business and ultimately that would contract jobs.

Our company is a member of the Coalition for Derivatives End-Users. We did a study that estimated the amount for business round table companies, of which FMC is a member, it would be on average $269 million of cash or committed credit that the average non-financial member of the business round table would have to hold aside to meet these margin calls.

And if we extrapolate that to the S&P 500 of which FMC is also a member, that would result in the loss of 100,000 to 120,000 jobs. And we haven't done the extrapolation across the broader economy, but here we are on the verge of the biggest change in financial regulations since 1934 without any of this cost-benefit analysis being done. I have seen no analysis from any government department, agency, or Commission that answers your question.

Mr. O'CONNOR. I can give some more comment on that and echo some of Mr. Deas's comments. And the CSA is effectively the part of the agreement that provides the collateral posting backwards and forwards, and I would say that generally between dealers and their clients and the financial end-users that the CSA is almost universally in place. Whereas, with corporate end-users I would say generally it was not the case that CSA's were in place in that market. Banks typically extended credit to those corporations.

Mrs. SCHMIDT. Thank you. Ms. Miller, you noted in your testimony concerns with the push out provision in Dodd-Frank. How would you propose to resolve this issue?

Ms. MILLER. Well, there is a simple way and there is a—sorry—the simple way would be just to give parity to the foreign banks and extend the language on insured depository institutions to foreign branches and agencies doing business here. But there is some thought that because of the idea of it would still require foreign banks doing business here as well as domestic banks to split apart their swaps dealer activity. And as we have talked—all talked about it, it makes sense to keep swaps activities in one central location. Another way to do it would be to completely get rid of section 716 and of course we would be supportive of that.

Mrs. SCHMIDT. Thank you. Moving along, Mr. O'Connor, what expectations if any should there be from real time reporting requirements and is the EU considering similar real time reporting requirements as well?

Mr. O'CONNOR. Thanks. So in terms of the expectations in the U.S., I think that the expectation is that for transactions printed between—in the OTC market those would be reported real time along through some form of tape mechanism like trades that exist in the bond markets. Those—that reporting would be applicable to all transactions that were not above a certain size. Those transactions would be—large transactions would be subject to block exemptions or block delays. There is uncertainty now as to where or the degree to which there has been enough thought about on setting those block levels. So if the block level is set at such that too many transactions are captured, that is—can be damaging to liquidity.

With regard to the second part of the question, I think EU is looking at real time reporting as well. A material difference in the U.S. and the EU is that the block reporting delay, which is another aspect so there is a size of trade that gets you to the block delay and then the question of how long the delay is, and I think the CFTC has proposed a delay of 15 minutes. In Europe it is a much longer delay. And what that means is that the liquidity provider, the dealer, can have more of a chance of hedging his risk before the trade is printed into the market and other market participants taking advantage of that information.

Mrs. SCHMIDT. Thank you. And Mr. Thompson, can you please provide further explanation of the indemnification provision in Dodd-Frank and how it would work in a practical matter and why this is a significant change from current practice, sir?

Mr. THOMPSON. At the moment, the Trade Information Warehouse works underneath the guidelines that were set in place by the OTC Derivatives Regulators' Forum, which essentially says that each one of the 50 regulators from across the globe is entitled to the information that they are entitled to based upon trades that either were done under a reference entity that they have, or a regulatee that they are particularly looking at if they—their market regulator. That would be—and at the moment that works. Those regulators come in, they make the appropriate statements as to what their rights are, and the Trade Information Warehouse gives them those information. And they also keep this information confidential. They agree to that.

The indemnification provision would essentially have the regulators coming in and essentially saying to the CFTC and to the repository that if something happens from a confidentiality standpoint and you are sued in the U.S. we will stand behind that lawsuit. We don't believe that there is any foreign regulator who in fact would subject themselves to any kind of lawsuit here in the U.S. when they can get the same information by simply putting in place their own local repository.

Mrs. SCHMIDT. Thank you. And my final question, Mr. Callahan, you noted in your testimony that CFTC's current approval process for foreign boards of trade to operate in the U.S. has worked well. You also note that this process is commonly known as no action relief which implies limited engagement by the CFTC. Can you briefly describe this approval process so that the Subcommittee may have a better understanding of what obtaining a "no action relief" actually involves?

Mr. CALLAHAN. Yes, and thank you for your question. Let me start by saying that I think that the no action relief regime is kind of poorly named and poorly branded because you are exactly right. It does imply by its name that there is no action being taken. Quite the opposite is true. There are over 20 foreign boards of trade currently subject to the no action regime. It is comprehensive. Our exchange, the London International Financial Futures Exchange or Liffe went through this process in 1998. It is comprehensive. There is voluminous amounts of information and material and data that is sent to the CFTC.

So between the CFTC and the regulated foreign board of trade it is a comprehensive process. But as a core part of the no action regime is the principle of comparability. The CFTC in their judgment decides that the jurisdiction of the foreign exchange is a comparable regulated entity. In our case that would be the DFSA in the UK and that has served I think U.S. market participants extremely well.

On the Liffe exchange in Europe which is operated by NYSE Euronext about ⅓ of the volume on those exchanges in which products such as Euribor, European Equity and DCE's, about ⅓ of the volume comes from U.S. customers so it is a great benefit to U.S. customers and U.S. investors to have that access to global markets. So we believe that it has been a success. Bart Chilton mentioned in his testimony the coordination with the ICE Exchange in Europe on the cash settled energy contracts. And I—there again is another great example of effective use of the no action regime.

Our concern is that the CFTC is a relatively small agency and the demand on its time and its resources are massive and only increasing through Dodd-Frank. So to require the re-registration of 20 foreign boards of trades and then whatever new ones come in the future, just the process of kind of redoing that whole exercise again is going to be massively time consuming and as Edmunds said in their letter to Chairman Gensler, it is unclear at the end of that huge piece of work that there is going to be any benefit to end-user customers or to the broader stability of markets. So sort of a question for us given scarce resources at CFTC is this really where they should be focusing their limited time and attention. Thank you.

Mrs. SCHMIDT. Under the rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional material and supplementary written responses from the witnesses to any questions posed by a Member. This hearing of the Subcommittee on General Farm Commodities and Risk Management is adjourned. Thank you.

[Whereupon, at 12:43 p.m., the Subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED LETTER BY HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

Execution Copy

United States of America Before the Commodity Futures Trading Commission

Petition by the Electric Trade Associations [1] ***for Prompt Reconsideration of Pending Petitions Under Section 723(c)(1) of the Dodd-Frank Act***

I. Requested Commission Action

The "Electric Trade Associations" respectfully submit this petition (this "Petition") to the U.S. Commodity Futures Trading Commission (the "Commission"). The Electric Trade Associations urgently request the Commission to reconsider the petitions submitted by the Electric Trade Associations in September of 2010 pursuant to Section 723(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") (the "Section 723(c)(1) Petitions"). The Section 723(c)(1) Petitions requested the Commission to allow the Electric Trade Association's members to continue to rely on the exemptions set forth in Section 2(h) of the Commodity Exchange Act (the "CEA") for a period of one year after the Effective Date [2] of Title VII of the Dodd-Frank Act.

The Electric Trade Associations request the Commission to reconsider such Section 723(c)(1) Petitions in a prompt manner (as required by Section 723(c)(2)(A). Concurrently, we request that the Commission promptly use its available exemptive authority under the CEA to prevent unnecessary disruptions to our members' ordinary business practices. The Commission is requested to assure that our members and all participants (our members' counterparties, without which the markets would not exist) in the over-the-counter ("OTC") derivatives markets for ***all*** "electric power and related commodity and commodity derivatives transactions" [3] can continue to operate under the existing exemptions and interpretations applicable to such transactions. The Commission should continue the existing market structure until such time as the Commission's rules establishing and regulating new "swap" markets in electric power and related commodity and commodity derivatives transactions are finalized, tested, and all implementation and transition periods have expired.[4]

The Electric Trade Associations' members regularly engage in electric power and related commodity and commodity derivatives transactions to manage the commer-

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[1] The Electric Trade Associations include the National Rural Electric Cooperative Association ("NRECA"), the American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the Edison Electric Institute ("EEI") and the Electric Power Supply Association ("EPSA"). This Petition is submitted by the Electric Trade Associations, and may not represent the views of any particular member of any one or more of the Electric Trade Associations with respect to any issue. The Electric Trade Associations are grateful to the following organizations who have provided assistance and support in developing this Petition. We are authorized to note the involvement of these organizations and associated entities to the Commission, and to indicate their full support of this petition: the Transmission Access Policy Study Group (an association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

[2] The date of enactment is July 21, 2010 (the "*Enactment Date*") and the date of effectiveness is 360 days after the Enactment Date, or July 16, 2011 (the "*Effective Date*").

[3] We use this term to mean (a) all non-cleared derivatives transactions referencing or derived on electric power or related commodities in which the Electric Trade Associations' members transact in the ordinary course of their core commercial activities, such as electric energy, natural gas, other fuels for electric generation (including coal and fuel oil, but excluding crude oil, gasoline or refined petroleum products other than fuel oil—these commodities are not germane to our members' core commercial activities, and the markets for these commodities and related derivatives are distinguishable from the markets in which our members participate), (b) those non-cleared derivative agreements, contracts or transactions referencing or derived on transmission, transportation, generation capacity or storage concepts or services related to the energy commodities described in (a), and (c) those non-cleared derivatives agreements, contracts or transactions referencing or derived on environmental or emissions regulations, or renewable energy or other environmental attributes, applicable to our members' commercial activities. All of these agreements, contracts and transactions reference or are derived on what the Electric Trade Associations consider "non-financial commodities," are intrinsically related to our members' core commercial (or non-financial) activities, and many are subject to the continuing jurisdiction of regulators other than the Commission.

[4] The Commission committed to ensure a smooth and seamless transition to the Dodd-Frank Act's regulatory scheme in its Notice *Regarding the Treatment of Petitions Seeking Grandfather Relief for Trading Activity Done in Reliance Upon Sections 2(h)(1)–(2) of the Commodity Exchange Act,* 75 FED. REG. 56512, on September 16, 2010 (the "Grandfather Notice") and in its response(s) to the Electric Trade Association's Petitions under Section 723(c)(1) in early December of 2010.

cial risks associated with their non-financial enterprise activities. These contracts, agreements and transactions in electric power and related "exempt commodities" may include, under the pre-Dodd-Frank Act regulatory scheme, "forward contracts," "trade options," "swaps," transactions executed on "exempt commercial markets." Our members may be "eligible contract participants," and all are "eligible commercial entities" in respect of the commodities related to the electric industry. Our members also engage in a wide variety of commercial contracts, agreements and transactions involving goods and services related to the electric industry in the various geographic regions of the United States. These transactions take place between non-financial entities and, in some cases, with financial entities as well. Some of these transactions have embedded optionality or "swap-like" economic terms.[5]

Many of our members' contracts, agreements and transactions are executed bilaterally in the OTC markets. Some are executed "in," "on" or "through" the regional transmission "markets" established in various geographic regions of the United States under the jurisdiction of the Federal Energy Regulatory Commission ("FERC"), rather than being executed on a designated contract market or on an exempt commercial market regulated by the Commission. Since September of 2010, the Electric Trade Associations and our members have filed comments in the Commission's rulemakings, and have met with the Commission and the staff on numerous occasions, to explain the unique aspects of our transactions and our markets.

II. Urgency of the Request for Reconsideration

In September of 2010, the Electric Trade Associations and our members, and other market participants in the OTC energy derivatives markets, submitted hundreds of petitions to the Commission asking for "grandfather relief" pursuant to Section 723(c)(1) of the Act. In December of 2010, the Commission responded to the petitioners and declined to grant the relief requested. The Commission indicated that it had not foreclosed the possibility of granting relief in the future and assured the electric industry and other petitioners of its commitment to ensure a smooth and seamless transition to the new regulatory scheme. Since it is now clear that final rules will not be in place by the July 16, 2011 Dodd-Frank effective date, the Electric Trade Associations request the Commission to promptly grant their Section 723(c)(1) Petitions to provide needed regulatory certainty as outlined below

A. The Commission Should Immediately Reconsider the Section 723(c)(1) Petitions and Grant the Requested Extension, and Use Its Exemptive Authority Under the Commodity Exchange Act To Allow the OTC Markets for Electric Power and Related Commodity and Commodity Derivatives To Continue Without Disruption

When the Act was enacted in July of 2010, Congress assumed that the Commission (and other regulators) could have an entirely new market structure for all "swaps" in all asset classes up and running within 360–365 days. In reliance on this unrealistic assumption, the Act automatically *deletes* the exclusions and exemptions from the CEA under which the current OTC derivatives markets operate as of July 16, 2011, the general effective date of Title VII of the Act (the "Effective Date"). As of July 16, 2011, the Act will simply label certain of the transactions in which our members engage for commercial risk management purposes as "unlawful."

Notwithstanding the efforts of regulators, their staffs, market infrastructure entities and financial and non-financial market participants, the comprehensive new market regulatory regime is not yet in place and will not be in place by July 16, 2011. However, the self-executing Effective Date deadline looms less than 60 days from today, and is creating serious regulatory uncertainty.

The Electric Trade Associations, on behalf of our members and all market participants in the OTC markets for electric power and related commodity and commodity derivatives, respectfully request that the Commission promptly grant the grandfather relief requested in the Section 723(c)(1) Petitions, and "use its available exemptive authorities to address such a [now imminent] situation." Grandfather No-

[5] Since September 2010, the Electric Trade Associations have requested the Commission to further define the term "swap," as used in the Dodd-Frank Act, to clearly exclude or exempt by regulation the types of commercial energy and energy-related transactions in which the Electric Trade Associations' members engage every day: including forward transactions in non-financial commodities which by their terms settle physically, commercial (or "trade") options on non-financial commodities, generation capacity, transmission and transportation services contracts, full requirements contracts, tolling agreements and energy management agreements, emissions and renewable energy contracts, and many "other specified electricity transactions." To date, the Commission has declined to do so. In fact, in the proposed rules on "Product Definitions," the Commission again asks questions about electric industry transactions, rather than providing by regulation the certainty the electric industry has been requesting since September 2010.

tice, 75 *Fed. Reg.* at 56513.[6] This will allow members of the Electric Trade Associations to continue their existing business practices which are focused on providing reliable, affordable power supply and which also take into account concerns related to price stability and predictability until such time as new rules are finalized and implemented. These practices are conducted in accordance with the requirements and expectations of Federal and state energy regulatory authorities, as well as existing law.

B. Granting This Petition Does Not Conflict With the Intent of the Dodd-Frank Act

Allowing the 1 year extension for electric power and related commodity and commodity derivatives transactions does not contravene the intent of the Dodd-Frank Act. Rather, the extension is consistent with the Congressional intent to reduce systemic risk and increase market transparency for standardized "swaps" while preserving access to cost-effective risk management transactions for non-financial end-users. The Commission and other regulators still face a monumental challenge to sequence the final rulemakings, and construct and implement its brand new "swap" markets in a manner that does not sacrifice the legitimate interests of non-financial "end-users."

Section 723(c) of the Dodd-Frank Act, the "grandfather provision," is a mechanism that offers market participants legal certainty during the period of implementation and transition to the new regulatory regime. Granting this petition for relatively minuscule portion of the global "swap" markets that may be represented by electric power and related commodity and commodity derivatives transactions will not impede the laudable goals of providing transparency and reducing risk to the financial system in the global derivatives markets.

III. Conclusion

The Electric Trade Associations respectfully request that the Commission promptly reconsider and grant the pending Section 723(c)(1) Petitions for the period of one year following the Effective Date, and use its available exemptive authority to prevent disruption in the OTC markets for electric power and related commodity and commodity derivatives transactions. The Electric Trade Associations submit that the Commission should do so to carry out the intent of Section 723(c) of the Dodd-Frank Act, and to provide legal and regulatory certainty to our members and American businesses and consumers who rely on our members to deliver reliable and affordable electric power.

Request for Prompt Reconsideration of Section 723(c)(1) Petitions

Respectfully yours,

National Rural Electric Cooperative Association

By: Russ Wasson

RUSSELL WASSON, *Director, Tax, Finance and Accounting Policy*

American Public Power Association

By: Susan N Kelly

SUSAN N. KELLY, *Senior Vice President of Policy Analysis and General Counsel*

Large Public Power Council

By:

NOREEN ROCHE-CARTER, *Chair, Tax and Finance Task Force*

Edison Electric Institute

By:

RICHARD F. MCMAHON, *Executive Director*

[6] The Act requires the Commission to act "in a prompt manner" to address the Section 723(c)(1) Petitions. See Section 723(c)(2)(A) of the Act. We respectfully note that the Petitions have now been pending for over 8 months.

Electric Power Supply Association

By:

DANIEL S.M. DOLAN, *Vice President, Policy Research & Communications*

CC:

Hon. GARY GENSLER, *Chairman;*
Hon. MICHAEL DUNN, *Commissioner;*
Hon. JILL E. SOMMERS, *Commissioner;*
Hon. BART CHILTON, *Commissioner;*
Hon. SCOTT O'MALIA, *Commissioner;*
RICHARD A. SHILTS;
DANIEL BERKOWITZ;
DAVID P. VAN WAGNER;
BEVERLY E. LOEW.

SUBMITTED LETTER BY HON. BART CHILTON, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION

May 26, 2011

Hon. K. MICHAEL CONAWAY,
Chairman,
Subcommittee on General Farm Commodities and Risk Management, House Committee on Agriculture,
Washington, D.C.

Dear Chairman Conaway:

It was a pleasure to testify before your Subcommittee on May 25. It is clear that, like you, Members of the Subcommittee have a keen interest in making sure our agency is deliberative and develops the best regulation regime possible under the expanded authority provided us by the Dodd-Frank Wall Street Reform and Consumer Protection Act. I share those ideals.

In response to your question regarding speculative positions in energy markets raised at the end of our panel, I submit the attached document(s) for the record. As you'll see, between June of 2008 and January 2011, there was a tremendous increase in the number of futures equivalent contracts held by non-commercial, speculative traders such as hedge funds, mutual funds, exchange traded funds and swap dealers.

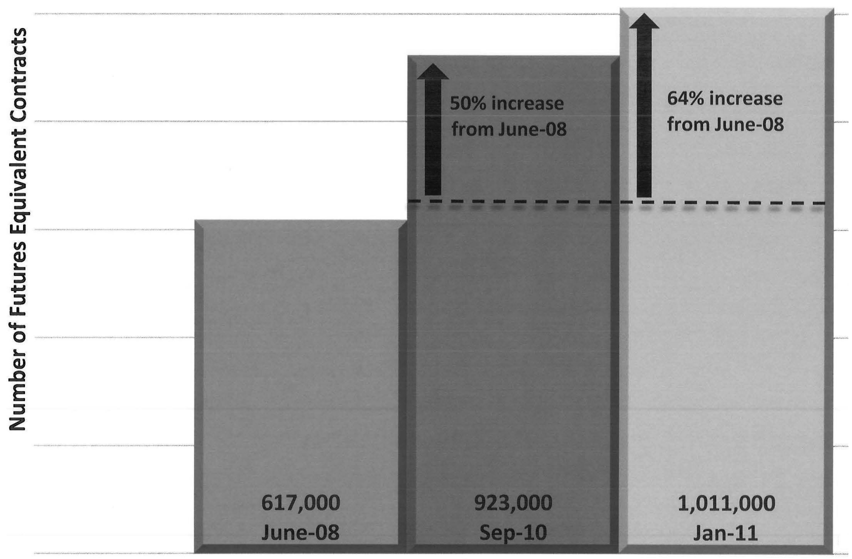
I hope this answers your question. If I can be of further assistance, please don't hesitate to ask.

Sincerely,

Hon. BART CHILTON,
Commissioner.

ATTACHMENT

Speculative Positions in Energy Markets



Source: Office of Commissioner Chilton, CFTC.

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