S. HRG. 112–503

CONTINUING OVERSIGHT OF THE WALL STREET REFORM AND CONSUMER PROTECTION ACT

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

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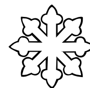

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CONTINUING OVERSIGHT OF THE WALL STREET REFORM AND CONSUMER PROTECTION ACT

Thursday, December 1, 2011

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

The committee met, pursuant to notice, at 10:07 a.m., in Room 106, Dirksen Senate Office Building, Hon. Debbie Stabenow, Chairwoman of the committee, presiding.

Present or submitting a statement: Senators Stabenow, Conrad, Baucus, Nelson, Brown, Klobuchar, Gillibrand, Roberts, Chambliss, Johanns, Boozman, Grassley, Thune, and Hoeven.

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

Chairwoman STABENOW. Good morning. Thank you for being here. We thank our witnesses this morning. This is the Committee on Agriculture, Nutrition and Forestry. We will call the meeting to order.

Today's hearing is part of this committee's continuing oversight of the Wall Street Reform and Consumer Protection Act. We know why reform was needed. The collapse of the financial industry cost taxpayers hundreds of billions of dollars and we lost eight million jobs. We passed Wall Street Reform to prevent systemic failures and to ensure that taxpayers are never again asked to bail out our financial institutions.

Wall Street Reform addressed four key areas: Systemic risk, full accountability and transparency, greater consumer protections, and better capitalization for the largest, most systemic institutions. The priority all along has been to protect consumers and to ensure that consumers can trust the integrity of our financial markets.

The crisis in Europe is a reminder of how important it is to get these rules done and to get them done right. We have already seen with the bankruptcy of MF Global how dangerously exposed our economy is to what is happening in Europe. The implications of this cannot be overstated.

Chairman Gensler, Chairman Schapiro, as you work to finalize all of the rules, I encourage you to harmonize your rules with each other and other prudential regulators, working closely with your global counterparts. We need a consistent set of rules, not conflicting or duplicative regulations.

And as you both know, a priority for me and many members of this committee has been protecting commercial end users—farmers, ranchers, manufacturers, co-ops, others who use the swaps market to hedge legitimate business risk. We put protections in place in Wall Street Reform for those end users and regulators, in my judgment, must follow Congressional intent.

The Wall Street Reform Act is bringing transparency and accountability to over-the-counter swaps for the first time. The MF Global bankruptcy underscores the importance of having effective oversight in all of our financial markets. We need these markets to function properly, and we need consumers to have faith in them. MF Global's customers included farmers, ranchers, co-ops, small businesses, and individuals who use these markets to hedge their business risk. They believed their money would be handled appropriately. They believed that the markets would function properly. They believed in the guiding principle of these markets, that their money would be kept separate from the firm's money.

Now their confidence is shaken and MF Global's customers are understandably very angry. With hundreds of millions of dollars of customers' money missing, maybe more than a billion dollars, it is clear that something went terribly wrong. As the committee continues to investigate this bankruptcy, we will be asking where the money is, how to get customers their money back, whether the bankruptcy was preventable, and whether the rules were appropriately crafted to protect customers' money.

I want to thank our witnesses today. You have been before us before. We appreciate very much your willingness on an ongoing basis to be with us, Chairman Gensler and Chairman Schapiro. I also appreciate that Commissioner Sommers is here to respond to any questions that Chairman Gensler feels he cannot answer about the MF Global bankruptcy. I appreciate the time and effort all of you have put into writing these rules, and we realize the task that we gave you, and for being here and being available to the committee.

At this point, I would turn to my friend and our Ranking Member, Senator Roberts.

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

Senator ROBERTS. Well, thank you, Madam Chairwoman. I appreciate your calling this hearing today. CFTC oversight, as you have indicated, is a critically important function of this committee. Our last hearing on this subject was about six months ago, and in light of recent events, I am looking forward to hearing from our witnesses for an update on how our regulatory authorities are coordinating their efforts with regard to the Dodd-Frank legislation.

It is time to get back, as you have indicated, to the core fundamentals over at CFTC. Congress created the agency back in 1974 to make sure the use of risk management tools, such as futures markets, were safe and secure for all of the participants. Unfortunately, in response to the financial crisis, the CFTC, in my view, has been off on a series of tangents, proposing one regulation after another.

Meanwhile, back at the ranch, for the first time ever, we have a major problem—a major problem—with one of our larger Futures Commission merchants. I am referring, as the Chairman has indicated, as well, to the collapse and bankruptcy of MF Global, the seventh or eighth largest bankruptcy in United States history, a collapse that occurred under the leadership of one of our former colleagues, Jon Corzine, and under the watch of the Commodity Futures Trading Commission headed up by Chairman Gary Gensler, also a former colleague of Mr. Corzine at Goldman Sachs.

On behalf of many investors, agri-businesses, farmers, ranchers, and their bankers across the country who are caught up in the events surrounding MF Global's bankruptcy, I want to thank the Chairwoman again for agreeing to schedule a hearing on December 13 for this committee to hear from the key players. Through no fault of their own, folks in Kansas, Michigan, all across the country, have been severely damaged economically by the actions and subsequent bankruptcy of MF Global. They want to know what happened and see that it does not happen again. But more importantly, they want to know what is being done to get this money back in the hands of rightful owners as soon as possible. We must find out what happened with MF Global and we must do so in a manner that restores faith in the futures markets and maintains them as a legitimate trusted risk management option for numerous producers and small businesses.

Madam Chairwoman, we cannot look past the critical oversight issues we must address regarding Dodd-Frank. I know that, and there are many. However, MF Global is the most pressing issue facing us today. Thousands of our constituents are looking at the possible loss of hundreds of millions of dollars and it has nothing to do with Dodd-Frank. We are getting more calls today in my home State of Kansas on this issue than we are having on the farm bill.

For many decades, the futures market has served as a way for agriculture producers and numerous small businesses to hedge risk. Without this ability, many could not stay in business. Throughout those decades, they have never once questioned the stability of the futures market until now. We need to get to the bottom of exactly what happened with MF Global. The lead in those efforts should be the CFTC and Chairman Gensler. I know that the CFTC is working hard, and I know Chairman Gensler has tried to step aside or be a nonparticipant or be recused and not let his past ties to Mr. Corzine create questions about the CFTC role in this process.

Unfortunately, the manner in which Mr. Gensler chose to step aside or recuse himself has raised more questions than it has answered. Why did he not recuse himself from MF Global issues from the beginning of his term if there was a conflict based on his previous relationship? Why did he wait until November 3 to decide he should step aside instead of doing it immediately on October 31, when everything came unraveled and MF Global declared bankruptcy? Why did it take the Chairman another five days to provide a recusal letter to his agency ethics officer? And why did it take him an additional two weeks to provide me a copy of that letter after I had requested it twice?

We must restore faith in the futures market so that our ranchers and farmers and small businesses can again know they can use futures to provide the risk management they so desperately need. This task and understanding what happened with MF Global must be our top priorities. A key first step on this path will be getting a better understanding today from Mr. Gensler on the answer to many questions that I have outlined.

Madam Chairwoman, I again thank you for holding this hearing and for an additional hearing you have scheduled on MF Global for December 13.

Chairwoman STABENOW. Thank you very much, Senator Roberts.

As is the custom of the committee, we will ask members to submit opening statements for the record so we can move to our witnesses today.

We have two distinguished witnesses who have been with us before. We are well aware of your distinguished backgrounds and appreciate again having your time and effort coming forward in cooperating with the committee.

So we will first start with Chairman Gensler, and we would ask you keep your statements to five minutes and then we will turn to Chairman Schapiro. Thank you.

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

Mr. GENSLER. Thank you, Chairwoman Stabenow, Ranking Member Roberts, members of the committee. I am pleased to testify on behalf of the CFTC. I am also glad to be here with Chairman Schapiro and CFTC Commissioner Jill Sommers.

Three years ago, both the financial system and the financial regulatory system failed, and as the Chairwoman said, more than eight million Americans still have lost their jobs and many Americans are struggling. And swaps played a central role in the crisis. There were other causes, as well. But swaps so important for managing and lowering risk for end users across this land also concentrated risk within the financial system.

In response, Congress and the President came together and passed Dodd-Frank. The CFTC is now working to complete Dodd-Frank rules thoughtfully, not against a close. The CFTC has actually benefited from public comment, over 25,000 comments, 1,100 meetings, 14 roundtables.

What have we done? We have substantially completed the proposal phase earlier this spring and we turn the corner to finalizing rules. We finished 18 rules but have a full schedule in front of us the rest of this year and well into next year. Each of the final rules have benefited from careful considerations of cost and benefits, and we appreciate all that people have sent in on that.

Just mentioning a few of the key rules we have completed, large trader reporting for physical commodity swaps, registration of the data repositories themselves, aggregate position limits, and risk management for the clearinghouses themselves. We have also finished rules giving the Commission more authority to prosecute wrongdoers that recklessly manipulate markets.

And next week, on Monday, we are going to take up a number of rules, one of them considering enhanced customer protections regarding the investment of customer funds, and we will look soon to finish rules on segregation of customer funds for cleared swaps. Segregation of funds is at the core foundation of the customer protection regime, as both the Chair and the Ranking Member noted, and both of these rules that we will take up shortly, I think, will help enhance the critical safeguards to customers. It will not be enough, though, and we are continuing to review all of our rule sets and audit and examination programs.

In addition, the Commission will consider rules next Monday with regard to registering foreign boards of trade.

Moving forward, we are working to finish shortly key transparency rules, including specific data to be reported to regulators through data repositories that will give the public more critical information. And as mandated by Dodd-Frank, we are working closely with the SEC on key definitions, definitions of swap dealer and swap which we hope to complete early next year.

The Dodd-Frank Act gives non-financial end users the choice of whether or not to use central clearing, the so to speak end user exception. Consistent with Congressional intent, and I think it is clear what Congressional intent is on this, the CFTC's margin proposal states that non-financial end users will not be required to post margin for uncleared swaps. The swaps market and the futures market are meant to be there so end users of all sorts can hedge risk, lock in a price of corn, wheat, or a rate, and then focus on what they do best and not be brought into the margining or clearing and so forth. We are conscious of that. We are dedicated to it.

The Commission is actively coordinating internationally to promote consistent standards. For instance, next week, Chairman Schapiro and I will be meeting with our counterparties over in Paris. Counterparties from Asia and Canada are also coming. I know Commissioner Sommers also heads up our Global Markets Task Force and we work closely trying to get this consistent around the globe.

I also anticipate the Commission will explicitly week public input on what is called the extraterritoriality application of Dodd-Frank, or there is a Section 722(d) was the specific section.

As we finalize rules, let me just say we do need additional resources. With just 700 staff members, we are about ten percent larger than we were at our peak in the 1990s, and since then, the futures market has grown fivefold and Congress has given us this new task to look at a market that is seven times greater than that fivefold market, or roughly $300 trillion in size. Without sufficient funding, the nation cannot be assured the CFTC can oversee the futures and swaps markets and enforce the rules to promote transparency and critically to protect the public, whether it is protecting customer funds or protecting against systemic risk.

Furthermore, the current debt crisis in Europe is just but a stark reminder that we need to complete financial reform and have adequate resources for the CFTC. Far more costly might be if the public were to maintain—to remain unprotected from the risks of the swaps market.

I thank you.

[The prepared statement of Mr. Gensler can be found on page 52 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Chairman Schapiro, welcome.

STATEMENT OF HON. MARY SCHAPIRO, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, DC

Ms. SCHAPIRO. Thank you very much, Chairwoman Stabenow, Ranking Member Roberts, and members of the committee. Thank you for inviting me to testify today regarding implementation of title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is a pleasure to appear with my colleagues, Chairman Gensler and Commissioner Sommers.

As you know, title VII primarily relates to the regulation of over-the-counter derivatives, creating an entirely new regulatory regime and directing the SEC to write a number of rules designed to bring greater transparency and oversight to this market. Since its enactment in July 2010, the SEC has proposed or adopted more than three-fourths of the many rules required by the Dodd-Frank Act and we continue to work diligently to implement all provisions of title VII.

As part of that effort, we have engaged in an open and transparent process, seeking input from interested parties throughout. Our Commissioners and staff have met with a broad cross-section of market participants. We joined with the CFTC to hold public roundtables. We have been meeting regularly with other financial regulators to ensure consistent and comparable definitions and requirements across the rulemaking landscape.

In addition, as Chairman Gensler mentioned, next week, we are convening with the CFTC and the European Securities Markets Authority a meeting of international regulators to talk through the status of derivatives regulation implementation in other jurisdictions and to address cross-border issues that are arising. We are working closely with foreign regulators to adopt consistent approaches to OTC derivatives market regulation that will both reduce cross-border risks to the financial system and address domestic U.S. competitiveness concerns.

To date, the SEC already has proposed rules in 13 areas required by title VII, including rules that would prohibit fraud and manipulation in connection with security-based swaps; address potential conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps; specify who must report security-based swap transactions, what information must be reported, where and when it must be reported, and what information will ultimately be disseminated to the public; require security-based swap data repositories to register with the SEC; define security-based swap execution facilities and establish requirements for their registration and ongoing operations; specify information that clearing agencies would provide to the SEC in order for us to determine which swaps must be cleared, and specify the steps that end users must follow to rely on the exemption from clearing requirements; establish standards for how clearing agencies should operate and be gov-

erned; impose certain minimum business conduct standards upon security-based swap dealers and major security-based swap participants when those parties engage in security-based swap transactions; and establish registration procedures for security-based swap dealers and major market participants.

In addition, with the CFTC, we have proposed rules regarding the further definition of the key terms within the Dodd-Frank Act, including swap, security-based swap, swap and security-based swap dealers, and major market participants.

In the coming months, we expect to propose the last of our title VII rules regarding capital, margin, segregation and recordkeeping requirements for security-based swap dealers and swap participants.

In addition, because the OTC derivatives market has become a truly global market, we are evaluating carefully the international implications of title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single proposal.

After proposing all of the key rules under title VII, we will seek comment on an implementation plan that will facilitate a rollout of the new requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and cost to the markets.

In conclusion, the Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace and fulfill our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As we proceed, we look forward to continuing to work closely with Congress, our fellow regulators, and members of the financial community, affected end users, and the investing public.

Thank you for inviting me to share with you our progress on and plans for implementation, and I look forward to answering your questions.

[The prepared statement of Ms. Schapiro can be found on page 63 in the appendix.]

Chairwoman STABENOW. Thank you very much to both of you.

As we begin, we do intend to do more than one round of questions today, so I will ask my colleagues to remain within the five-minute time frame for each round and we will do at least two, and depending on interest and time, we can go from there.

Before I ask my opening questions, though, I know that Senator Brown has to preside, so on behalf of all of us, we thank you for presiding over the Senate and I will yield to you for a moment to submit some questions for the record.

Senator BROWN. Thank you. Thank you, Madam Chair. I actually would—I have to leave in a few minutes, but thanks for that, and I would just like to say a few words and ask a question now and they can answer it either now or later, whatever works. Thanks, Madam Chair.

Chairwoman STABENOW. Sure.

Senator BROWN. First of all, thank you for your public service, both of you, Mr. Chair, Madam Chair. I appreciate that.

As we know, the MF Global episode is just the latest example of the dangers of inadequate oversight. In 1984, a downturn in the

energy markets caused the failure and bailout of the bank Continental Illinois. The 1998 crisis in East Asia and in Russia caused the failure and bailout of the hedge fund Long Term Capital Management. And more recently, the mortgage market caused the failure and bailout of many of our most prominent financial institutions. So there are many lessons.

One of the lessons is not all crises, of course, not all crises are exactly the same. That is why we need to give the market watchdogs adequate resources so they can oversee these markets and prevent, or at least minimize, the damage of the next potential crisis. That means giving CFTC the necessary funding to carry out both the great responsibilities we have given them in the Dodd-Frank Act and the everyday responsibilities to supervise derivatives markets. Trading volume, for instance, increased 400 percent from 2000 to 2010, while CFTC staff increased nine percent, completely apart from, previous comments notwithstanding, completely apart from Dodd-Frank.

Wall Street allies in Congress, and there are far too many of them, are trying to cut funding because they do not like the idea of greater oversight and transparency of these markets. As we have seen in MF Global, this is a dangerous game, this cynical, almost Orwellian contention that the financial crisis was because of too much government and the dangerous game because of underfunding agencies that need to be watchdogs. It puts at risk the companies in States like Ohio and Michigan that Senator Roberts mentioned. It puts those companies at risk in those States that use these markets.

So a couple of questions, Mr. Chairman, if I could ask you. What sort of decisions will CFTC have to make with regard to its priorities in this funding situation, what you can project? What are the implications of these decisions for your role in overseeing markets? And third, can you effectively implement Dodd-Frank at that funding level? If you could sort of pull all three of those together.

Mr. GENSLER. It is a challenge. I think that we will be successful, or, I say, largely successful completing the rule set, but we will not have the people to help oversee the market or even answer all the questions that people have, the hundreds if not thousands of questions, interpretation, registration, applications, and that is a challenge for us. Congress just increased our funding by $3 million for this coming year we are in right now, but ringfenced $18 million additional dollars for technology, and we sorely need more money for technology, but the arithmetic means we have to find $15 million of cuts elsewhere because they took the top line up three and ringfenced $18 million elsewhere.

This means we will not do things. We currently—there are many things we should do already that we are not doing, like annual examinations of the clearinghouses. We do not yet do that. We do not have on-site people. We do not, as the recent questions—we rely on the self-regulatory organizations to examine what is called Futures Commission Merchants. We do not individually go in there. That is the routine we have.

So there is a lot that we probably will not do, but we will be able to complete the rules, largely. I mean, it is a human exercise.

Maybe some will not get done. But we will complete the rules but not have the people to oversee the markets.

Senator BROWN. Do you, Chairman Gensler—MF used window dressing tactics, this sort of repo to maturity, borrowing client funds against its sovereign bond investments to mask its exposure. Its auditor, CME, did not detect these actions until, frankly, too late, apparently. Your fellow Commissioner Chilton said that you have the authority to conduct deep data dives into companies. Have you directed your staff to use that authority? Do you agree with Commissioner Chilton that you do have that authority, and second, are you doing that?

Chairwoman STABENOW. I would ask you to be brief in your answer.

Mr. GENSLER. I am not familiar with his quote, but we do have general authority to ask for data from Futures Commission Merchants, and what we are doing right now is doing, along with the CMA, a limited review of all the Futures Commission Merchants about their segregated accounts.

Senator BROWN. Okay.

Mr. GENSLER. We hope to complete that by the end of this month.

Senator BROWN. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much, and we will now move back to regular order.

As we look, to both Chairman Gensler and Chairman Schapiro, when we look at all of the issues involved, in some ways, it is hard to know where to begin in terms of the questions. But one thing that bothers me is that MF Global's collapse has shattered the faith of many in the futures markets. I am very concerned that customers are now questioning whether they will ever use the futures market to manage risk again. The protection of segregated customer funds, as we have mentioned, has been a cornerstone of the futures industry for years, but the MF Global situation has brought all of that into question. Customers were shocked to find out that their money could be invested without their consent. And it is even more shocking that certain risky transactions were considered permissible investments. The idea of sacred segregated customer funds has really been thrown out the window.

Chairman Gensler, you have spoken about the fact that there are rules that you have looked at that would limit the permissible investments of customer funds. They have been looked at earlier this year. You are now having a meeting next week. But my first question is, why has the rule not been finalized up to this point? Have there been disagreements among the Commission, the Commission members regarding the rule, and if so, can you explain those disagreements?

Mr. GENSLER. We in October of 2010 proposed enhancements to the investment of customer funds. I have personally consistently felt that we need to do it. It is not necessarily just Dodd-Frank. And we have a very busy agenda. We did provide such final drafts to Commissioners this summer and there was still continued debate, so I chose to continue to have the dialogue with my fellow Commissioners. But I think next Monday, we will take this up. Segregation is the key foundation of this and I think it is impor-

tant that we limit how funds can be used, as Congress intended. The statute only allows investments in Treasuries and three or four other areas and this would really narrow an earlier exemption that in 2005 the Commission granted.

Chairwoman STABENOW. And is your expectation that the rule will be adopted next week?

Mr. GENSLER. I think it would be fair that I let the process go, that Commissioners vote on Monday and I not get ahead of individual Commissioners. But I certainly scheduled the vote hoping that they would have that support. But there still may be some deliberation.

Chairwoman STABENOW. Thank you.

I would like to ask both of you about the question of red flags, both with MF Global but broadly as we look at the companies under your jurisdiction. MF Global was a significant player in the global futures markets, significant customer base. It was also an example of a company with a history of problems. And so, broadly, looking at companies, using this as an example, the CFTC fined this particular company in 2009 for risk supervision failures, including a $141 million trading loss on wheat futures. We have documents that show 35 regulatory actions taken by FINRA against MF Global. Also, MF Global's annual report filed earlier this year indicated dangerous leverage and risky exposures to European debt crisis, and I have great concern about the implications for other companies, as well, if we are going to see other companies in the same situation.

But these are very serious red flags and examples. So as we look broadly at this kind of an example, for companies like this with this kind of a record, should there be more oversight, such as additional disclosures or more frequent audits that could identify problems before they are too late? And where do we go with this at this point? And, Chairman Schapiro, I would ask you to respond first.

Ms. SCHAPIRO. I would be happy to. Thank you. Let me just say that, by comparison, the securities business at MF Global was quite small. There were only 400 active securities accounts. But nonetheless, FINRA, which is the self-regulatory organization upon which the SEC relies in large measure for broker-dealer oversight, had been in the firm over the summer, quite concerned about whether there was sufficient capital supporting the repo to maturity transactions which involved the sovereign debt and required the firm to increase its capital levels. The firm actually appealed that to the SEC and we supported FINRA's decision that they needed to infuse capital into the firm at that time.

I will say that while our equivalent of the segregation rules, 15c3–3, are also quite strong rules and are a foundation of broker-dealer solvency and customer protection, we are also looking at whether there are additional rules that ought to be in place on the securities side. One that we actually proposed earlier this year that I hope the Commission will take up and finally adopt relates to the requirement for a more regular audit by a Public Company Accounting Oversight Board registered auditing firm of the custody arrangements that broker-dealers have. We put in place two years ago a similar rule with respect to investment advisors post-Madoff. We have now proposed to extend that toe broker-dealers and we

think that such a rule that would look very carefully through the leverage of a third party accounting firm at whether a firm is complying with its financial responsibility rules could be very helpful.

I will also say that FINRA recently put in place requirements for qualifications exams and registration of back office personnel, which I think would be very useful in the context of a situation like this, and they filed with us and it is now out for comment some additional rules for more detailed financial reporting that I think would also have been very helpful in monitoring the situation here.

But I think that FINRA was there in the summer, supported by the SEC.

Chairwoman STABENOW. Thank you very much, and in the interest of time, my time is up, so Chairman Gensler, I will come back to you at a later point to answer that question. I am going to turn to Senator Roberts.

Senator ROBERTS. I thank you, Madam Chairman.

Chairman Gensler, as I mentioned in my opening remarks, I had several questions pertaining to the Commission's development of the new Dodd-Frank regulations. Thank you for your call the other day. We went over possibly five rulemaking issues and I appreciate that conversation. But before I get to those, I would appreciate clarification of your role—we may have to do that on the second round, maybe third round—in the events surrounding MF Global's bankruptcy. When did you first know there was a problem with MF Global?

Mr. GENSLER. I think as the week of October 24 developed, staff briefed our Commission, I think it was probably Wednesday. We normally have a briefing Wednesday, and then we had another briefing Friday of that week.

Senator ROBERTS. Then that confirms my understanding that MF Global was downgraded on October 24, obviously, that Monday. Did that raise a real red flag at the Commission? Did you feel that this was a very serious problem at that time?

Mr. GENSLER. Well, I understood that staff had increased monitoring. Other regulators and the CFTC were in contact increasingly as that week ended and into the weekend, and with the key focus being the protection of the customers and moving the customer positions in the funds throughout that weekend.

Senator ROBERTS. All right. I understand the CFTC had staff in Chicago from Wednesday, October 26, through Friday, the 28th, looking into MF Global's segregated funds. This tells me the CFTC had very serious concerns about these accounts five days before the bankruptcy. I also understand CME reconciled the segregated accounts on Wednesday. You folks were in your offices looking at the same accounts through Friday. Yet on Monday, almost a billion dollars was missing from these accounts.

Now, this leads to several questions. What involvement to date have you had with MF Global, both since they began to deteriorate and regarding regulatory issues that might have affected their business prior to their bankruptcy?

Mr. GENSLER. My involvement, sir, over that weekend, along with the regulators from the SEC and international regulators, was the focus on moving customer positions and ensuring the customers

were protected. There was a series of calls, particularly on Sunday, with that regard.

Senator ROBERTS. Well, then why—given that, why did you step aside or, as you have said, step aside or recuse or non-participate, I am not too sure which one it is, as you have said previously, from MF Global issues?

Mr. GENSLER. I had reached out to the agency ethics officers and General Counsel of the agency during that week of October 31 and they ensured me that there were no legal or ethical reasons that I needed to non-participate. But I told the General Counsel that Thursday that I thought that it would be best not to be a distraction to the really important work of this talented staff at the CFTC——

Senator ROBERTS. But why would it be a distraction?

Mr. GENSLER. I just thought just there were—I had left Goldman Sachs 14 years ago, and though I had worked on Sarbanes-Oxley in 2002, a Senator at that time but then subsequently the CEO of the firm had worked a bit back in 2002, and the lawyers had assured me there was no reason—no legal or ethical reasons, but I thought it could be a distraction in the media and the press, and as that Thursday came, we were about to have a Friday closed-door surveillance meeting that we have that has been true for 30-plus years at the agency and I thought I should stand aside when it was clean and before the closed-door surveillance started to get into these very important matters of where is the money.

Senator ROBERTS. Well, if you thought it was best to remove yourself from matters involving MF Global during its demise and you thought that would be a distraction because of your relationship with Mr. Corzine, Senator/Governor Corzine, why did you not remove yourself from all issues involving MF Global? Did something in your relationship change?

Mr. GENSLER. No. What had changed was that there was a developing enforcement investigation specific to possible civil and criminal actions.

Senator ROBERTS. I appreciate that. The time line surrounding your statement of non-participation is a little confusing to me. Your response to my letters raises questions about who was in charge of the work in the early days of this event.

According to your letter, you notified your General Counsel that you would not participate in enforcement matters. Why did you come to this realization on November 3? As you have indicated, October 24 was the first big red flag, although there had been earlier indications that would be a problem. Had you not been participating in official CFTC actions regarding MF Global before this date?

Mr. GENSLER. As I said, over those last days of the week and the weekend, along with other regulators from the SEC and around the globe, we were focused on really, first, monitoring, two, moving positions, and three, ensuring against any systemic risks. As it turned into potential enforcement, civil and criminal, and before the surveillance meeting that Friday, I was ensured by the General Counsel and the ethics folks their views, but I also indicated that I thought it could be a distraction for the really talented career staff doing their work——

Senator ROBERTS. I appreciate that.

Madam Chairman, I am over on time and we have other members here, but I want to continue this line of questioning at least for a short time before we get to the rulemaking questions and I appreciate that. Thank you.

Chairwoman STABENOW. Thank you.

Senator Baucus.

Senator BAUCUS. Thank you, Madam Chairman.

I would like you both to know, and I know you already know, that this is not an academic exercise for a lot of people. I am speaking about farmers and ranchers who legitimately hedge, want to lock in a price, a very common transaction, common exercise. It is what they do to help manage their operation as good businessmen and women.

There is one fellow in Montana and his name is Marty Klinker. He has lost 300—actually, he had $336,000 in liquid assets at MF Global and 108,000 open trades with MF Global. As of this date, he has received about 60 percent. He is about 40 percent out. And the prospects for Marty getting the rest of his funds back are pretty grim, it seems. He legitimately is very put out.

[The Hon. Max Baucus submitted an addendum for the above statement]

> [I would like to submit an addendum to my statement from the Agriculture, Nutrition, and Forestry Committee hearing that took place on December 1, 2011. I would like to clarify the amount of money that Montanan Marty Klinker has gotten back from his MF Global accounts. In my statment, I said Marty had received 60 percent of his money back. That is the amount he has received from his cash accounts. The amount he had received back as of December 1, 2011 from his open trade account was 20 percent. This is an important distinction and it should be noted in the official record.]

There is a Grain Growers Convention going on in Montana as we speak and the talk there is not the farm bill. It is not anything else. It is MF Global and farmers there who have lost a good portion of their assets with MF Global, and they are a bit angry, and they should be angry.

I mean, look what has happened. Right now, public opinion of Washington, D.C., is at an all-time low. Look what happened with the 2008 financial collapse. How can ordinary folks trust Washington with their money? How can they? I think, frankly, that the 2008 debacle is very simply explained. It is just a bunch of greed without sufficient adult supervision. I mean greed up and down the lines, from the mortgage brokers, the bankers, and so on and so forth, and insufficient regulations, insufficient adult supervision, whether it is private supervision or government supervision.

And here is a case where Marty, for example—and he is not alone—has lost a lot of money. He trusted the system and the system let him down. So how is Marty going to get— and other farmers and ranchers—how are they going to get their money back? And what can you say to Marty? What can you say to farmers around the country that, hey, you can still trust the system, you know, trust us? I mean, this is a pretty simple violation, it seems

to me, just as the failure to segregate accounts. That is basic and even something as basic as that was not honored by the company, by the self-regulator, and even by CFTC and the other appropriate agencies here.

So, number one, when is Marty going to get his money back, and how much of it is he going to get back? And what can you say to farmers and ranchers and others who legitimately hedge as a good business practice and who are not being protected when agencies are not looking sufficiently at these companies to make sure that companies are doing what they are supposed to be doing?

Mr. GENSLER. I think, as I am not participating in the specific matter, I might have to defer part of your question to CFTC staff or Commissioner Sommers, but if I could just generally say that I think you are absolutely right. The system has to work for the farmers and ranchers and energy companies and all of the people that need to lock in a price and segregation is at the absolute core of this system that has been existent for decades. Now, we do rely on self-regulatory organizations, and we are looking at every piece of the CFTC, with Commissioner Sommers' help where I am not participating, but looking at every piece of the CFTC on how the audit function works and whether we should adopt some of what the SEC has, that there has to be a separate audit of the segregated accounts, how the examination function, which we do not actually do the examination, it is done at the self-regulatory organizations, as well——

Senator BAUCUS. But just basic, ordinary English. You are out at the Grain Growers Convention and the farmers there are asking you, Commissioner Gensler, what can you tell me that can reassure my trust that I can hedge and next year that my funds are protected?

Mr. GENSLER. Uh——

Senator BAUCUS. What can you tell me? What assurance can you give me in plain English, what are you going to do, in the basic way people talk?

Mr. GENSLER. Umm, what we are doing at our agency is turning over every rock in every corner as to our rules and what we can do better and being self-reflective because we know that this has to be better. These funds have to be separately segregated. I think that probably we need more transparency where these Futures Commission Merchants have to tell their customers where they are putting the money, as well. We are actually tightening up rules next week on how they invest the money that they get——

Senator BAUCUS. Do you think the current rules are insufficiently loose on——

Mr. GENSLER. Yes, I did in October of 2010 when I supported a rule to change investment of customer funds——

Senator BAUCUS. You think so today, too?

Mr. GENSLER. What is that?

Senator BAUCUS. You think so today, too——

Mr. GENSLER. I think what we might do next Monday will help, but yes, I think so. I think we have to tighten up something about use of money. You could actually since 2005 use customer money and lend it to another part of an affiliate or in-house at the same. You could lend it to the proprietary trading side of a firm. You

would have to get collateral back. It is called—something called repurchase agreements. But I think we need to tighten that up and I have felt that since October of 2010.

Senator BAUCUS. Well, I just urge you—I mean, I do not want to over-dramatize this, but, you know, we are the hired hands. We are the employees, you and I. The employers are the people who work for it in the country and they want us to, as employers, to do what we are supposed to be doing, and that is making sure that there is an orderly procedure here and that their accounts and sufficiently protected. They will gamble, I mean—that is not the word— they will hedge, they will take that risk, that is legit. They want to make sure that their funds are in the appropriate account and somebody is not taking advantage of them by the proprietor taking their funds for their own account.

Chairwoman STABENOW. Thank——

Senator BAUCUS. And they want you to make sure you are taking care of them.

Chairwoman STABENOW. Thank you very much. Well said.

Senator Grassley.

Senator GRASSLEY. Thank you, Madam Chairman.

Chairman Gensler, first of all, thank you for your forthright recusal and thank you for the gentlemanly conversation you had with me on that subject.

I want to follow on where Senator Roberts left off. What specific event caused the CFTC staff concern with MF Global that week of October 21—no, October 24? As you had mentioned, staff concerns were raised at the beginning of that week.

Mr. GENSLER. I am doing this from memory, sir, but I thank you for your thanks. It was a good conversation we had on that week about my not participating.

Senator GRASSLEY. Sure.

Mr. GENSLER. As I recall, the firm was downgraded by a rating agency, but I think it was Wednesday, the 26th, that staff first briefed us in our regular weekly briefing meetings they had been downgraded. I think that was the initial—they also may have reported a quarterly loss in their financials.

Senator GRASSLEY. Okay. Then the second question, when CFTC analysts were examining the records of MF Global prior to October 31, were there indicators that there were problems with the segregated accounts? What were those indicators? And how early did CFTC officials see those indicators?

Mr. GENSLER. As this is all a matter of specific investigation, enforcement investigation, if I could just more generally answer that, because I do not want to say something that might prejudice an investigation that I am not even participating in, but the lawyers have said they do not want me to inadvertently prejudice something—

Senator GRASSLEY. Okay.

Mr. GENSLER. As I understand it, over those last days of the week and over the weekend, we as regulators were trying to ensure that customer positions and customer funds were fully segregated and could be moved. I participated in some phone calls on that Sunday throughout the day and into the 31st when, of course, the company officially said they had a deficiency. All companies, all Fu-

tures Commission Merchants have to give us a deficiency notice, and it happens from time to time. A bit of money moves inadvertently. It is usually a day and then it is cleaned up. That deficiency notice came on the 31st from them.

Senator GRASSLEY. Okay. My next question, it has been reported that in the early morning hours of October 31, the CFTC was notified that customer money was missing from the segregated accounts at MF Global, who informed the CFTC of this shortfall in the segregated accounts. Who discovered the shortfall in the accounts?

Mr. GENSLER. Again, I am not participating in these matters, so I might need to, to the extent CFTC staff or Commissioner Sommers would want to be referred to that, those questions about the specifics of the investigation.

Senator GRASSLEY. Okay. Does that mean you want me to get an answer in writing, or you want somebody else to—I would like to——

Chairwoman STABENOW. Senator Grassley, if we might, we had asked through Chairman Gensler Commissioner Sommers, who is handling the investigation, to be here for questions. Commissioner, if you would want to step forward and answer Senator Grassley's question.

Senator GRASSLEY. Thank you.

Ms. SOMMERS. Good morning, Senator. It is my understanding that on the morning of October 31, CFTC staff were informed by MF Global staff that there was a shortfall in the customer segregated funds account.

Senator GRASSLEY. Okay. My last question, Chairman Gensler, prior to October 31, did you have any discussion with MF Global CEO Jon Corzine about the state of affairs at MF Global and whether MF Global was in trouble, and if you did have conversations, when were those conversations and what did Mr. Corzine convey to you?

Mr. GENSLER. The only conversations I partook in with MF Global is with the regulators over that weekend, and I do not remember exactly, because Chairman Schapiro and I were on so many of those calls Sunday and into the a.m. of Monday, but the group of regulators from London and here were on calls that MF Global presented from time to time, and as I recall, the CEO of that firm at least once spoke up, but I am not sure because there were other people tying into a conference call that probably had 20 to 50 people on it.

Senator GRASSLEY. But at least he was very much involved in the discussion with people of CFTC staff.

Mr. GENSLER. I actually do not know, because——

Senator GRASSLEY. Okay.

Mr. GENSLER. —I was not physically at the company.

Senator GRASSLEY. Okay.

Mr. GENSLER. But that long regulatory call, I only recall him speaking up once.

Senator GRASSLEY. Yes. Madam Chairman, I thank you. I would like to associate myself with the remarks that Chairman Baucus made about how this affects people at the grassroots of America, because we have had calls. I am not sure that they are quite as

colorful as what he had, but still, we have had very concerned citizenry.

Chairwoman STABENOW. Well, thank you very much, Senator Grassley. I think we all have received those calls and share your concern about this and I think that is certainly a general feeling of every member on this committee, a deep, deep concern about what has happened here.

Senator Nelson.

Senator NELSON. Thank you, Madam Chairman, and thank you all for being here today, both the Chairs of SEC and the Commodity Futures Trading Commission.

I want to also associate myself with the comments about the correspondence and the calls we have gotten from Nebraskans who have felt the impact of this unfortunate situation.

Madam Chairwoman, I appreciate you calling this hearing because I think it is important to get the oversight authority out in the open and find out what, in fact, has happened to try to protect future situations from happening, but also responding to the current situation, as well.

I have got a couple of questions. I really want to make a comment or two or relate a comment or two from some Nebraskans who have been in touch with us. While today's hearing is to focus on implementation of the Wall Street Reform and Consumer Protection Act, I have heard so many comments from folks back home that they are struggling with this bankruptcy. They have had their accounts frozen. They are uncertain if they will be made whole and when they might be made whole. Others received checks from their excess margin accounts only to have them returned when deposited. There appears to be a lack of information on which customers can rely to resume normal trading and risk management activities. And I understand there are some unprecedented circumstances surrounding this collapse. But I would like to know what rules are currently in place to protect customers like my constituents from Nebraska. What rules— they are inadequate, but what kind of rules are conceivably there?

Mr. GENSLER. Senator, the rules are very clear. It is actually right in Congressional statute, and then there are associated rules that customer funds are to be segregated at all times of the day. It is not just at the end of the day. There is a once-a-day calculation at the end of the day, but no one should confuse that once-a-day calculation that all times of the day the money is to be segregated in bank accounts or in various securities accounts. I do not know if there are similar rules on the security side, as well.

Senator NELSON. Chairman Schapiro?

Ms. SCHAPIRO. Yes, sir. We have a rule called 15c3–3 which requires that broker-dealers have physical possession and control of all fully paid and excess margin securities of their customers. It is a calculation that is done once a week because it is quite a complex calculation. But the goal is to tie up and protect customer funds and assets. And unlike the CFTC rule which Chairman Gensler is working hard to change, customer funds on the securities side can only be invested in government securities that are backed by the full faith and credit of the United States. So there is an additional level of protection there.

Senator NELSON. It would not be sovereign funds, for example.

Ms. SCHAPIRO. No. Full faith and credit of the United States.

Senator NELSON. All right. Exactly. Let me read from a letter that we got from a person from a small town in Nebraska. Vern says, "How can we stop people from stealing money from segregated accounts which are supposed to be safe? What can I do about this and what can my Senator do about it?"

I have the same feeling that my colleague, Senator Baucus, had, that people back home expect all of us back here to protect them. Now, Vern understands that he has market risk when he hedges. He does not expect to have account risk, and they are different, entirely different. So I guess I tell Vern we are going to straighten out the account risk issue so that in the future he can take the market risk but he does not have to worry about whether his money will be in an account when he needs it, subject to, of course, market risk, but it is altogether different.

The other one that I would like to read is from somebody who is an attorney representing a number of people who have now contacted him regarding MF Global, and he says, "Members of the Agriculture community are willing to take risk. We know that when we plant crops and pray for rain. We know that. However, it is unreasonable to expect farmers, commodity traders, and grain elevators to anticipate that MF Global would convert segregated customer funds into a financial play on European sovereign debt." He goes on to say, "This has a chilling effect on trading in the agricultural markets. Market players can no longer trust the market. This has the potential to be a huge systemic problem in and of itself."

Do we run the risk of what we were worried about with the Dodd-Frank bill, the potential of not just one entity but systemic risk with all the entities in connection with account risk because of their investment in sovereign funds? Yes, Chairman Schapiro.

Ms. SCHAPIRO. I think, Senator, there is not really any good news about MF Global and it is a tragedy, what has happened, particularly for people in your State and others who are relying on these markets for legitimate hedging and risk mitigation activities.

But to the extent there is any silver lining, it is that MF Global ultimately was not systemic and did not cause——

Senator NELSON. No, as an entity, it is not, but is the fact that others are in this subject to the same situation a systemic risk until it is, in fact, taken care of by additional rule, regulation authority?

Ms. SCHAPIRO. That would be very hard to judge, but I think it is really incumbent upon all the regulators to look at whether we do need to have stronger rules, whether we need to have better audit and oversight of custody arrangements, including segregation and reserve account arrangements. And at the end of the day, when people violate those rules, very tough enforcement, very strong sanctions in order to send a broader deterrent message throughout the financial community that these rules are sacrosanct. They absolutely are the underpinning of investor confidence in these markets and the regulators will take swift and sure action.

Senator NELSON. Is it safe to say that when rules are in place, it is anticipated that people will follow them, but enforcement is the way in which you deal with it when they do not follow them?

Ms. SCHAPIRO. That is right. I mean, our system requires that we rely on people to obey the law, I mean, because we do not have a regulator in every firm. We do not have a policeman on every corner, as much as sometimes that seems like it would be a good way for us to go forward. We have to rely on people to be following the rules.

That said, there has to be oversight of their activities through the self-regulatory organizations, through the regulatory agencies, through a strong rule set, through the rules we are trying to go forward with, that would have accounting firms sort of enlisted in our—to our assistance and making sure that funds are where they are supposed to be. And then, as you say, enforcement.

Senator NELSON. Thank you, Madam Chair. Thank you both.

Chairwoman STABENOW. Thank you very much.

Senator Boozman is next in terms of appearance, but I understand you are deferring to Senator Johanns, is that correct?

Senator BOOZMAN. Yes, ma'am.

Chairwoman STABENOW. Senator Johanns.

Senator JOHANNS. Thank you, Madam Chairman.

If I could have the Commissioner return to the table, and this is probably a question for both the Commissioner and the Chairman. We have just heard that we need more rules and this and that and the next thing. But as a lawyer, this seems real straightforward to me.

You know, when you practice law, you have a trust account and your client will sometimes put on deposit money to pay filing fees or deposition costs. Then you have your bank account to pay your staff salaries and whatever else, the draw you took out of the law firm, whatever it was. And if you mix those two, or if you took that money out of the trust account and used it for your personal desires, whether it was gambling in Vegas or buying and selling stock, you committed a crime.

No matter how we sanitize this, it seems to me, would you not agree, that we have a situation where you have a trust account where trusting people put their money into that and somebody abused that trust and took that money and basically played like you would play in Vegas. They made very bad bets and now the money is gone. Do you disagree with that characterization, Commissioner?

Ms. SOMMERS. I do not disagree, Senator. I do not disagree. I think that, like Chairwoman Schapiro, I believe that you can have the strongest and most effective oversight and it may not prevent people from violating the law.

Senator JOHANNS. Mr. Chairman, would you agree with my assessment of this?

Mr. GENSLER. Well, I want to be careful because I am not participating on the particular company. But as a general, general matter, I think it is pretty straightforward that segregated accounts are meant to be segregated, similar to your analogy of the escrow accounts at a law firm. It is not always technically the same, but they are really supposed to be segregated, invested prudently. The

statute says there are only four or five things it can be invested in. We did as an agency back in 2005 widen that. It is my hope that we can narrow that back down again. But they are still supposed to be kept for one reason, for customers.

Senator JOHANNS. You know, Mr. Chairman, I am not going to give you the same kudos that Senator Grassley gave you, and here is why. As you know, for about three years, I sat in a similar position to yours, huge operation, the USDA. But when I was called to task by the Senators, they did not give me a pass. I was not able to say, well, this is a big organization and we have got offices all over the world and, gee, I do not know this and I do not know that. They wanted answers.

Here is my concern with where you are at. My concern is that a week ago or so, you said, "I will recuse myself." It looks to me like you are trying to avoid the heat. You certainly did not recuse yourself all of the other weeks and months and days while MF Global was doing what it was doing. Why is it that they could get away with this and all of a sudden we have got innocent people in States like Nebraska and Montana and Arkansas, et cetera, who it looks to me are going to come up on the short end of the stick. Do you agree with me, you folks failed?

Mr. GENSLER. I take very seriously the responsibility that I have as a Commissioner and Chairman and the responsibility of the whole agency to ensure for the protection of customers and their funds. That is why I was involved that weekend, along with other regulators, to ensure that customer positions and funds were properly moved. As it went into an enforcement and investigative matter, though I had not worked at the similar firm for 14 years with an individual who might be actually the individual themselves might be under investigation, I thought I did not want to distract from that very important matter for the career staff.

But that does not absolve me in any way from the broader responsibilities that are the agency's, just as you said. You had a bigger agency to run, but I take very seriously that we have got to go back through every piece of what we are doing as an agency, whether it is our rules, our reliance on the self-regulatory organizations and the examination functions, and really see how we can foster greater confidence in this important segregated accounts system.

Senator JOHANNS. Commissioner, let me point that question at you. Would you agree with my assessment that you folks failed?

Ms. SOMMERS. Senator, I think that the investigation is still ongoing with regard to what the actual events that happened at MF Global—what those actual events are, so I cannot comment on whether or not what ends up being found is the fault of the regulator. I think that we will find out, and if it is, obviously, there is something that needs to be done about the way that we implement our regulations.

Chairwoman STABENOW. Thank you.

Senator JOHANNS. Thank you, Madam Chairman.

Chairwoman STABENOW. Thank you very much.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Madam Chair.

As we know, the focus of today's hearing was supposed to be on this oversight of the implementation of the Wall Street Reform and Consumer Protection Act, but today, this important topic is being overshadowed by the collapse of another over-leveraged financial firm that took on too much risk and did little to disclose its bets.

Three years after the U.S. financial system was nearly toppled by this sort of recklessness, it seems that little has changed, and you look at those that say that Wall Street Reform was not necessary, that we have learned from our mistakes, that we do not need stronger rules, I would have you talk to the farmers in my State that cannot access their life savings and are not sure when or how much of it they will get back.

Dean Tofetland from Luverne, Minnesota, a town of 4,600, his family grows corn and soybeans and raises pigs on their farm in Southwest Minnesota. He currently has over $200,000 in what was supposed to be a segregated MF Global account which he cannot access and which he does not know how much he will ever get back. He is not a speculator. He uses the futures market to manage risk, locking in prices of the growing season so he is protected against price fluctuations that can eat into his profits. Those are the kind of people that we have been hearing from in Minnesota.

Now, I guess my first question is, we know some of the actions that are being taken. You mentioned, Chairman Gensler, that we are looking at the rules. But just for average people out there in my State trying to figure out how this all works, I know Chairman Schapiro mentioned that of MF Global, something like 400 accounts were under your jurisdictions, and those are not the ones we are talking about here.

So then we have the CFTC, Chairman Gensler, that has jurisdiction, but in fact, the Chicago Mercantile Exchange somehow has jurisdiction, as well. Could you explain this so I can explain it to the farmers in my State?

Mr. GENSLER. If I can explain it on the general side, just so I do not step over the line of where my counsel says I can go, because I am not participating on a particular company, but what happens is there are some firms that are regulated both by the Securities and Exchange Commission and the CFTC because they do both brokerage and they do futures business, and so they have both of us together.

And to the extent it is over on our side of the watch, we rely on self-regulatory organizations such as the Chicago Mercantile Exchange to do the examinations and the day-to-day, and that has been true for decades. That is the nature of our agency. It is about a 700-person agency, as I have mentioned.

We do get notices from companies if they are deficient, and the Chicago Mercantile Exchange as a self-regulatory organization works very closely with us and we do what is an examination of the SRO itself, but the SROs are the ones that are the front-line regulators.

Senator KLOBUCHAR. Okay. And I do not know if Commissioner Sommers wants to come up for these questions here. So that is what happened, and supposedly they were filing these forms with the Chicago Mercantile Exchange and everything was supposed to be looking good until the very end here. And so I am just trying

to figure out what we need to do differently. In my second round, I am going to ask about this actual problem and how they recover their money.

But in 2005, the rule was somehow expanded—Chairman Gensler, you mentioned this—so they could invest these segregated funds in more things, including sovereign debt, is that right?

Mr. GENSLER. In 2005, it was expanded to include lending the money to another side of the firm and taking back collateral. It is called a repurchase agreement. The sovereign debt expansion might have been a couple of years earlier.

Senator KLOBUCHAR. Two-thousand, I think, is that right?

Mr. GENSLER. Yes.

Senator KLOBUCHAR. Okay. So, over time, we have kept expanding, and now suddenly we are going to finally go back and look at it and retract it. But you clearly think that is one of the things that could solve this going forward?

Mr. GENSLER. Well, I thought in October of 2010 that we should narrow back. As Chairman Schapiro says, over in the securities world, it is just government securities and the statute book. What Congress has actually said to the CFTC is a very short list of four or five things. From 2000 until 2005, we exempted and let it get wider. We are still deliberating as a Commission, but I think that we should not allow what is called affiliate repurchase agreements or in-house, where you take customer money and lend it to another side of the house.

Senator KLOBUCHAR. Okay. Then another area I wanted to ask about as we look at solutions that I think Chairman Schapiro mentioned broadly, this idea of transparency and getting things out there more, one thing we know about this for sure is that a $6.3 billion bet on the bonds of troubled European countries, such as Spain and Italy, set this chain of events into motion. It is further known that MF Global hid the risks that should have been on its books through complex repo transactions in which it pledged the bonds to a third party in return for a loan with a promise to buy the bonds back when same matured. When these risky bets came to light, this triggered a loss of confidence. The result is the eighth largest bankruptcy in U.S. history. Pain is being felt in little towns like Luverne, Minnesota.

So one question I have is should we reexamine how companies disclose their off-balance sheet risk or the use of repo agreements altogether?

Chairwoman STABENOW. And I would ask that— unfortunately, I know that is a very important question, but I would ask you to be very brief.

Ms. SOMMERS. Maybe I will take that one. FASB recently revised the accounting standard for repos and the only repos now that qualify for off-balance sheet treatment are repos to maturity, the type that, as you mentioned, MF Global entered into with respect to the sovereign debt. And while the disclosure that surrounds those is an improvement over what used to exist, I think it is a fair question and we are discussing with FASB whether or not we need further revision of the disclosure and accounting standards around repo to maturity.

I also want to be very clear that we are investigating very carefully both the accounting treatment and the disclosure by the firm and we will be looking at it closely.

Senator KLOBUCHAR. Whether it was legal, and then you are also——

Ms. SOMMERS. Whether it was in accord with GAAP and whether the disclosure was sufficient around how they disclosed the repos, the hedges that were expiring, window dressing. All of those issues are under investigation.

Senator KLOBUCHAR. But there might be some further work that could be done to——

Ms. SOMMERS. And we are talking to FASB about whether further revisions are needed.

Senator KLOBUCHAR. Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Chambliss.

Senator CHAMBLISS. Thanks, Madam Chairman.

Chairman Gensler, in light of the recent collapse of MF Global and the related ongoing investigations, do you think it is really prudent to continue to impose a futures industry model on the OTC derivatives industry without a complete analysis of the practices of MF Global and the regulation of MF Global?

Mr. GENSLER. Senator, I think that one of the core reasons of the 2008 crisis was the swaps marketplace. It is seven times the size of the futures marketplace and I think we are making good progress, but I do think that we continue. We are not—there is a lot of very, very good features of the futures industry and the swaps industry already benefits from many of those features voluntarily, but I think it is important to bring that which we can into clearinghouses. That is just the standard part of the market. And that which we can to greater transparency, into data reporting, and to the public so that the public gets the benefit of that transparency.

Senator CHAMBLISS. You just finalized a rule establishing the requirements applicable to clearinghouses that would set a minimum capital requirement for clearinghouse members at $50 million. That is much lower than the amount currently required by clearinghouses. It is my understanding that this $50 million threshold was criticized as being too low both by members of the Commission as well as other members of the industry. It is also my understanding that one of the firms pushing for the lower capital requirements was MF Global. Can you please explain how you arrived at the $50 million number and whether you did any sort of economic analysis to determine whether or not that number makes sense from a risk management perspective?

Mr. GENSLER. One of the features of the Dodd-Frank Act was that the clearinghouses have open access. In the futures world, in fact, in the securities world, the public has benefited by the competition that brings, that people can use either a big firm or a smaller firm to help access the clearinghouse. In the swaps world, it has been more, shall I say, exclusive. Some of the swaps clearing was more exclusive.

So we proposed, and then as you rightly said we finalized a rule that said that the clearinghouses would have to accept parties that

are smaller, but they can scale them. So if somebody only has $200 million in capital, they cannot have the size that somebody with $2 billion in capital. It has to be scaled, but they—to allow greater competition and more market access following Congressional intent to have open access.

But I think that any clearing member has to have all the operational capabilities. They have to show that they can risk manage. And it is up to the clearinghouse as to set those operational risk management and how they scale based on capital. So I am agreeing with you. It is critical that every clearing member meets the robust and rigorous requirements to protect customer money and to be a member of a clearinghouse.

Senator CHAMBLISS. You have been the Chairman now for going on three years, and you went through Dodd-Frank with us in great detail. What does your experience tell you with respect to how many systemically risky entities there are out there? What is an estimate?

Mr. GENSLER. Were you counting just this country or Europe, as well, sir?

Senator CHAMBLISS. Well, let us start with just this country.

Mr. GENSLER. I think that the Dodd-Frank Act has the Financial Stability Oversight Council look at entities over $50 billion of assets, but the largest entities, there are maybe about ten or 12 that are over $250 billion, if I can recall the figures. And, of course, there are global organizations that I am not a member of but I have identified something called global systemically important financial institutions.

Senator CHAMBLISS. Do you believe swaps dealers are in that category of systemically risky?

Mr. GENSLER. Some of them. Not all of them, but some of them, sir, certainly are.

Senator CHAMBLISS. So, obviously, that is a yes, then, I assume. That being the case, how can you justify capturing commercial entities who are clearly not systemically risky in that systemic category, that risky category? And by that, are you telling this committee that a collapse of a grain co-op in Omaha or a dairy co-op in Michigan would threaten the integrity of the U.S. financial system?

Mr. GENSLER. Senator, I think that commercial enterprises are not going to be swap dealers, and there may be some swap dealers who are not large Wall Street banks, but I think it is going to be a group that are actively making markets, accommodating demand in the markets, regularly putting themselves to buy or sell swaps. And I think that the tens of thousands of end users will be end users. They are not going to be swap dealers. That grain merchant that you are referring to, unless I am mistaking which one you could be talking about, I cannot imagine would be a swap dealer.

Senator CHAMBLISS. So it is not your intention to apply regulatory measures to them the same as the systemically risky entities?

Mr. GENSLER. We are in agreement on that, sir.

Senator CHAMBLISS. Okay. Thank you.

Chairwoman STABENOW. Thank you.

Senator Conrad.

Senator CONRAD. Thank you, Madam Chairman. Thanks for holding this hearing. Chairman Gensler, thank you for being here, Chairman Schapiro, as well.

First of all, let me just say, we have had six contacts from my State, two customers, four broker-dealers. One of the broker-dealers has told us he has got $500,000 that is out there in the ether somewhere and, you know, that is a huge amount of money, certainly to that broker-dealer, and he is deeply concerned. He is asking, how can this happen? How can this conceivably happen?

Let me go to that question. Under the law, it is my understanding that customers' funds that are segregated can be invested in sovereign debt, is that correct?

Mr. GENSLER. Under the Commodities and Exchange Act, they were not allowed to be in anything other than the sovereign debt of the U.S., but there was an exemption, I think it was in 2000, that the Commission granted to invest in sovereign debt if the customer gave you that currency. So it is in a narrow situation. If the customer gave you, for instance, the currency of the United Kingdom, Sterling, you could put it into the United Kingdom's sovereign debt called Gilts.

Senator CONRAD. So is that change that was made long before you were ever there includes any sovereign debt?

Mr. GENSLER. I believe that the exemption that was granted and still is on the books is if a customer gives you a certain currency, you can invest it just in the sovereign debt of that country to which that currency——

Senator CONRAD. I see. But that is any sovereign debt. So it could be Greek. It could be Libyan sovereign debt. It could be——

Mr. GENSLER. I do not know the Libyan currency, but if somebody gave you the Libyan currency, I believe, but we could get back to you specifically, sir, on that.

Senator CONRAD. So there was no standard with respect to rating agencies' assessment of the risk of that sovereign debt?

Mr. GENSLER. Let me just—I think I am going to have to get back to you, Senator.

Senator CONRAD. Well, I would be interested to know. Is there any standard with respect to the sovereign debt?

Mr. GENSLER. See, you have reminded me, and I am sorry. It took a moment. Your second question helped me a lot. The rules in place include a rating agency provision about being highly rated. Dodd-Frank actually said that we could no longer rely on rating agencies and we had to remove the reference to rating agencies in all our rules. So the current exemption does rely on ratings, highly ratings, so the Libya or the junk credit country maybe could not happen.

Senator CONRAD. Okay.

Mr. GENSLER. In October of 2010, we had to remove that in the proposal and it sort of lost part of this—it is part of this rule, is that we have to remove any reference to ratings.

Senator CONRAD. Okay. Let me go back to where I started, because I want to make sure I have got this right in my head. The notion that money that is in segregated accounts, in a customer's segregated account, separate from the company's operating accounts, that can be invested by law in sovereign debt to the extent

that the customer provides the currency of the country for which that sovereign debt applies.

Mr. GENSLER. That is the current rules. It may be limited right now to this rating agency, but, you know, that it had to be highly rated. But yes, that is, as I understand it.

Senator CONRAD. The next question I have is the Securities Investor Protection Corporation provides insurance up to $500,000 on an account. Is that not true, Chairman Schapiro?

Ms. SCHAPIRO. Yes, that is right.

Senator CONRAD. But on the other side of the ledger——

Ms. SCHAPIRO. For securities accounts——

Senator CONRAD. That is for securities accounts. For futures accounts, there is no insurance available, is that correct?

Mr. GENSLER. That is correct.

Senator CONRAD. And what is the—again, this happened long before you were there, but do you understand what the rationale was for there not to be insurance?

Ms. SCHAPIRO. It is long before my time, as well. I am not even sure when SIPC was created, maybe in the early 1970s——

Senator CONRAD. But you have got it in securities.

Ms. SCHAPIRO. Yes.

Senator CONRAD. You have got a $500,000—as I understand, you can get $500,000 of insurance. Is that $500,000 automatic?

Ms. SCHAPIRO. Well, there is a claims process that the SIPC trustee would administer to determine whether——

Senator CONRAD. But, I mean, you have got automatic coverage up to $500,000 in order to——

Ms. SCHAPIRO. Effectively.

Senator CONRAD. Yes. Why would there not be insurance on the futures side available?

Ms. SCHAPIRO. I would say, and certainly Chairman Gensler should jump in, that is something that Congress certainly should consider, whether it does make sense. It has worked pretty well on the securities side. There are lots of questions about——

Senator CONRAD. Okay.

Ms. SCHAPIRO. —how does a segregation regime and an insurance regime interact. There are lots and lots of questions, but——

Senator CONRAD. Let me go——

Ms. SCHAPIRO. —we would be happy to provide——

Senator CONRAD. I have got one other—Madam Chair——

Chairwoman STABENOW. Yes, if we do it briefly. Thank you.

Senator CONRAD. The thing that is most curious to me, in the Wall Street Journal, they say MF Global's trading frenzy might have attracted more attention if it had not been hidden. The purchases of European government bonds added up to several times MF Global's entire market cap. But by using this repo to maturity technique, those trades were considered sold for accounting purposes and therefore they disappeared from MF Global's balance sheets.

I do not know if, Chairman Gensler, you are the appropriate one to ask, because you are recused from this investigation, but I would like to know, how is it possible that somebody is able to bet the farm multiple times here, multiples times their market cap, and it

disappears from their balance sheet because of this repo to maturity technique that considers them sold.

Ms. SOMMERS. Senator, I will be happy to try to answer that. As I had mentioned to Senator Klobuchar. FASB recently revised their accounting standards around repos so that the only repos that do qualify for off-balance sheet treatment are repos to maturity. We are talking to FASB about whether that is a policy that ought to be changed. They did improve the disclosure around it, but there is a question, I think, about whether repos to maturity should be included on the balance sheet.

And I want to also be very clear. We are investigating the disclosure and accounting by this firm. What they did disclose in their second quarter 10–Q was that they had net exposure to sovereign debt. They did disclose, but not very clearly, or not as clearly, their gross exposure. They reported that they had $16.5 billion in reverse repos of which 70 percent was collateralized by European sovereigns. So not as direct as the net exposure disclosure.

I think these are——

Senator CONRAD. Well, I would just say in conclusion——

Ms. SCHAPIRO. —very fair questions for——

Senator CONRAD. —that is a loophole so big you could drive a Mack truck through it. My God, if that is not closed down, we have really got to ask ourselves what we are doing.

Chairwoman STABENOW. Thank you.

Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair, and we do appreciate you all being here.

Today, it sounds like we all agree very definitely that accounts must be segregated. If a person does not segregate an account and essentially steals the money, takes it and gambles it away—and we are not talking about any specific situation, but just in general—gambles it away, is that a rule breaking or is that a criminal process? Either one is fine.

Mr. GENSLER. Well, it——

Senator BOOZMAN. What is the penalty for doing something like that, besides getting fined?

Mr. GENSLER. It is quite clear in the statute and in the rules of the commodities world that customer funds need to be segregated and that those monies can only be invested in a certain list of permitted funds.

Senator BOOZMAN. Mm-hmm.

Mr. GENSLER. They are not to be used for some other purpose other than for the customer, and that is supposed to be all day long, every day.

Senator BOOZMAN. Right. And if somebody does that, though, if they break that rule and they use those funds for riskier investments or whatever, what is the—what happens to the individual who does that?

Mr. GENSLER. Under——

Senator BOOZMAN. Or individuals?

Mr. GENSLER. I might have to defer to have staff to get back to you, but on the Commodities and Exchange Act, we just have civil money penalties that we pursue in segregation cases. So it is just civil money.

Ms. SCHAPIRO. The SEC is also a civil enforcement agency, so we would have the ability to fine someone, to——

Senator BOOZMAN. Yes. Well, I think the problem——

Ms. SCHAPIRO. —expel them from the industry——

Senator BOOZMAN. and I do not mean to——

Ms. SCHAPIRO. —but the criminal authorities could certainly pursue a criminal case if they can meet the standards of proof that are required there. Breaking the rules can and should lead to enforcement action and, where appropriate, criminal action, as well.

Senator BOOZMAN. I guess the problem that I have, and I think the people of Arkansas, is that if you go into a financial institution and you rob the bank or you rob the financial institution, that is a Federal crime. That is highlighted if you saw "J. Edgar Hoover," the movie, recently. But there is no ifs, ands, or buts. The resources of the Federal Government are going to come to bear and you are going to go to jail for that crime.

If a person through doing this other essentially can steal hundreds of millions of dollars and there is no penalty except for some civil penalty, that is a real problem.

Mr. GENSLER. Senator, if I can add, my good General Counsel was able to tell me the words. In the Commodities and Exchange Act, it does say if an individual knowingly and willfully—knowingly and willfully violates the Commodities and Exchange Act, that is a criminal violation for the individual.

Senator BOOZMAN. And we have a history of prosecuting those kind of things?

Mr. GENSLER. It has happened.

Senator BOOZMAN. Well, that is not a history. And again, this is a real problem and this is why the American people are losing faith in their institutions.

Now, tell me about you all in the sense that one of the concerns I have, you can be so close to these things that you almost do not really realize when things are going on. What is your protocol for investigating yourself in this process? Are your IGs involved now, or what is going on?

Ms. SOMMERS. We will do a lessons learned review——

Senator BOOZMAN. So will you have an IG investigation regarding this?

Ms. SOMMERS. I am not sure what they would investigate——

Senator BOOZMAN. Well, we had the meltdown in 2008, lots of stuff going on. We passed Dodd-Frank, tremendously increasing regulation. This stuff continues to go on. I guess I would like to know, and I think the American people would, to make sure that the individuals in your agency are actually doing the job that we entrust them to do.

Ms. SOMMERS. Well, that is certainly very——

Senator BOOZMAN. And it is hard to self-regulate yourself. You said yourself a while ago that you are the policemen, and I agree with that. The policemen have separate departments when things happen, and something big has happened, to make sure that the people involved were doing the appropriate thing.

Ms. SOMMERS. Senator, I agree, and we will carefully— I do not know through what mechanism at the agency's response here, but we should be clear that this was potentially violations of a very,

very serious nature by the firm that caused this firm to fail. And while we will always look at our conduct to see if we can do better and do more, you know——

Senator BOOZMAN. We want to make sure, also, that there was not, how would I say it, just—well, for whatever reason, that the agencies did not do as good a job as they could have done in making sure that they were policing the— to make sure that this did not happen in regard to this instance. I mean, is that fair?

Ms. SOMMERS. I think it is always important for regulators, when there has been a problem in an industry, whether it is the May 6 Flash Crash or any other kind of event, to take a look at whether things could have been done differently. We always do that.

Senator BOOZMAN. So an IG investigation would not be an overreach?

Ms. SOMMERS. Well, we will take some approach to looking at what we can do to tighten up our rules, tighten up our procedures——

Senator BOOZMAN. Thank you.

Ms. SOMMERS. —approach our examination processes differently, whether FINRA did, and I would imagine on the commodities side the CME did as effective a job as possible.

Senator BOOZMAN. Madam Chair, I hope that we can talk about this again. I think that would be very, very appropriate. Thank you.

Chairwoman STABENOW. Well, thank you, Senator. And as you are aware, we do have a specific hearing on December 13 regarding MF Global and we will——

Senator BOOZMAN. I cannot wait.

Chairwoman STABENOW. We will have a number—starting with the victims, because I think that is the most important thing for us, is to make sure we understand what this is really about, and this is real people that have been hurt in this situation. So thank you very much.

Senator Thune.

Senator THUNE. Thank you, Madam Chairwoman, and I agree that this hearing has essentially evolved into an MF Global hearing already.

But I think everybody here at the table—we have heard—several of my colleagues have shared what they have heard from their constituents who are suffering economic damage as a result of the failure, and I want to just read one of the messages that I received from a South Dakota grain elevator manager, and I quote, he said, "This MF Global failure is causing tremendous stress in our and other business operations as we are unable to use our futures accounts and unable to access funds. The continuation of this may cause my industry to suspend purchasing grain from farmers as we are unable and unwilling to hedge our purchases in an exchange that is not secure. This lack of certainty and security is starting to make traders across the world question the security of all positions, even those not held in MF Global accounts. Timeliness is of utmost importance. The trust that we all have in the regulated futures industry is at stake," end quote.

And I guess the question I have is—an observation and a question—but marketing agricultural commodities through hedging and

use of futures has become nearly as important as growing the crop. What has occurred with MF Global has severely damaged these practices for many producers and facilities, and in plain and simple terms, what is your plan, not only of action items, but also in terms of outreach to the agriculture community, that use of hedging and futures markets can be safely continued.

Mr. GENSLER. What we are doing at the agency, and Commissioner Sommers may have things to add to this specific to the individual company, but what we are doing is really asking ourselves and asking the staff and each Commissioner what we can do better. Specifically, what we are doing now, along with the CME and the National Futures Association, is conducting on-site reviews—they are limited reviews, but on-site reviews of all of the Futures Commission Merchants. We have taken the top dozen or 14 and we have gone in looking at the segregated accounts. The CME is taking the next 35 or 40. And then the NFA are taking the others. And we are hoping to finish these this month of December.

But beyond that review of the segregated accounts, really looking at our whole procedures of audit. We do not audit, actually. There is an annual audit that is required under the law and under the rules. But should that be more robust and more enhanced? It is an audit of the Futures Commission Merchant. It is not an audit specifically of the segregated accounts. How do we add to it and enhance that? The examination functions of the self-regulatory organizations, how do we enhance that, working, of course, along with the CME, and just going straight across the board, but I do not know if Commissioner Sommers would want to add. Any lessons learned out of that particular company, of course, she and others will be closer to than I will because I am not participating now.

Senator THUNE. Do you think these steps are going to be—and you said end of December?

Mr. GENSLER. In terms of just our limited review——

Senator THUNE. Right.

Mr. GENSLER. —of these large firms.

Senator THUNE. And the steps that you intend to take, do you think that they are going to be adequate? I mean——

Mr. GENSLER. Well, I think it is important that customers have confidence, and the farmers and ranchers and the energy companies, they just have to have confidence that their funds are not only segregated, but they are theirs. They are not somebody else's to, you know, to divert in any way. And that confidence is at the core, because these products are important so those farmers and ranchers focus on what they do well and then they lock in a price of wheat or corn or soy and they do not have, as I think Senator Nelson, was it, said, they do not have account risk.

Senator THUNE. Right.

Mr. GENSLER. And, in fact, they do not even want market risk because they are trying to lock in that price and then the focus on the risk of the rain and the yields and so forth.

Senator THUNE. Well, I just—I guess the question I am trying to get at is how do you—can you assure us and those who have lost money as a result of MF Global that adequate protection is now in place so that this does not occur again in the future. I mean, I think that is, at the end of the day, what people want to know.

There is the money that has been lost and hopefully can be recovered. But then there is the concern about what steps are being taken so that there is certainty and confidence in the markets and in this process.

Mr. GENSLER. Let me ensure you that I think all of us at the CFTC are focused on exactly that, that there is confidence in these markets so that end users can properly use these products, and that working along with the self-regulatory organizations, that segregation means segregation.

Senator THUNE. Okay. I see my time has expired. Thank you, Madam Chairwoman.

Chairwoman STABENOW. Thank you very much.

Senator Hoeven.

Senator HOEVEN. Thank you, Madam Chairman.

My questions go to Dodd-Frank and then we will use MF Global as kind of the example to help you explain an answer to the questions I have.

Given that you had Dodd-Frank, which the idea was to provide for more transparency, improvements in terms of reducing systemic risk, and enhancing regulators' ability to make sure they understood the risk of firms on an individual firm basis and better oversee and regulate systemic risk throughout the financial services industry, what did Dodd-Frank—how did Dodd-Frank impact what happened at MF Global? Why was it not effective in helping prevent the kind of failure that occurred? How did it help? How did it not help?

Ms. SCHAPIRO. Senator, I guess I would say that the violation of the segregation rules on the commodities side was already illegal long before Dodd-Frank. Those are rules that have been the cornerstone of futures regulation for many years. So I am not sure that Dodd-Frank specifically sought to address the kinds of issues that were at MF Global.

I will say, I mean, what broke down here was the framework for the protection of customer assets based on the actions by this firm, which, as I say, not knowing exactly what happened yet, and hopefully we will know soon, may well have been illegal.

Dodd-Frank did not really eliminate the potential for firms to go out of business. It sought to help us ensure that firms could be—that were systemically important unwound in an orderly way without creating reverberations throughout the financial system. And it sought to close gaps with respect to transactions, like over-the-counter derivatives that had not been subject to regulation.

It also, importantly, created a process for the Financial Stability Oversight Council to look at firms like MF Global, that if they met certain trigger points would be subjected to an additional layer of regulation by the Fed, so at the $50 billion asset level and then hitting another trigger, like leverage or concentration or interconnectedness, could subject a firm to being designated as systemically important and subjected to additional oversight. But that process has not been put in place yet and FSOC has not made those determinations.

Senator HOEVEN. So, Chairman Schapiro, you would say Dodd-Frank had no impact in this case?

Ms. SCHAPIRO. Well, I think much of Dodd-Frank is not implemented yet anyway. I do think that had the FSOC process been in place, potentially, MF Global is a firm that could have been on the radar screen. I do not know that, but I am just using that as an example of a way Dodd-Frank could potentially have made a difference.

What happened here, and really Chairman Gensler should speak to this because it is on the commodities side, to the extent the segregation rules were violated by this firm, if they were, those are longstanding rules that well predate Dodd-Frank.

Senator HOEVEN. Chairman Gensler.

Mr. GENSLER. As I am not participating in matters with regard to this one firm, if I might just talk—the core of your question so is wrapped up in one firm, it is a little challenging, so can I take it just as a general question about Dodd-Frank?

Senator HOEVEN. Well, we can try that, sure.

Mr. GENSLER. All right. Otherwise, staff or Commissioner Sommers may be more appropriate to address your question.

But Dodd-Frank really addressed in title VII the regulation of swaps for the first time and does have similar protections for the first time on segregation of customer funds in the swaps marketplace, and that is very clear that Congress's intent was that people get the protections for segregated funds in the swaps world which they are meant to get in the futures world already.

But as Chairman Schapiro said, Dodd-Frank also will not turn around the longstanding thing, that financial firms will, from time to time, fail.

Senator HOEVEN. Specifically, and I understand, Chairman Gensler, you may not be in a position to answer this question based on your earlier testimony, but certainly Chairman Schapiro, specifically what are you doing to help customers recover, and specifically what recommendations would you have that would help prevent the kind of problems that we are experiencing with MF Global?

Ms. SCHAPIRO. Well, Senator, let me just say again there are a very small number of securities accounts at MF Global. The trustee has identified less than 400, I think about 330 of them, that are non-affiliated and non-insider customer accounts that are custody accounts, and he is in the process of asking the court to permit him to transfer those securities accounts to another brokerage firm that is qualified to handle them. And that motion by the trustee was filed with the court yesterday. I think the court will hear it next week. And that will remove the vast majority of the securities accounts——

Senator HOEVEN. Would they be limited to their SIPC coverage or would they be transferred in whole?

Ms. SCHAPIRO. The trustee has proposed in this motion that he will transfer cash and securities for these accounts at the SIPC net equity up to the limits of SIPC protection plus 60 percent of the net equity. In short, what that means is that about 85 percent of the securities account customers will be made whole through this transfer, because these were relatively small securities accounts, and, of course, quite small in number in comparison to the futures accounts.

Senator HOEVEN. If I could beg the indulgence of the Chairman for just another minute or so, specifically, your recommendations to prevent this kind of problem and do what we can to make sure that customers are made whole in the future, and then, Chairman Gensler, to the extent you are willing to take a shot at this same thing on the commodities side.

Ms. SCHAPIRO. Well, on the securities side, we have proposed in June of this year rules that would require brokerage firms that have custody of customer assets to get an additional audit by a PCAOB registered accounting firm. That will give us another set of eyes on the financial responsibility compliance of the firms and I think that will be very important.

We will look carefully at whether there are other things we can be doing. I hope that we will approve a rule proposal that is pending before us from the self-regulatory organization FINRA that would require additional financial reporting to them so they can monitor more closely issues like sovereign debt exposure at brokerage firms. And, of course, we are pursuing an active investigation with the potential for enforcement action at the end of the process.

Senator HOEVEN. Thank you.

Chairman?

Mr. GENSLER. Again, let me just talk more generally, and then if others at the agency or Commissioner Sommers wish and you wish to chat with. But more generally, I do think it is important that we move forward on the rule that we are considering next Monday on the investment of customer funds, to sort of step back from some of the exemptions that we gave in 2005 and earlier for the use of customer money to be loaned to affiliates or in-house. I think that is an important step.

But beyond that, I think that it is important for the agency to continue this process of looking at our relationship to the self-regulatory organizations and where the examination functions are and what transparency we can bring, greater transparency to the reporting to customers themselves as to where their money is. Currently, they sort of get one line item.

Senator HOEVEN. Mm-hmm.

Mr. GENSLER. And that transparency, so the customers can really see, are you in cash or securities or something else, I think would be a very important step. But I would not limit it to that transparency. I think we, as the firms relate to their self-regulatory organizations and the self-regulatory organizations relate to us, we need to sort of look at all of those pieces as to possible enhancements.

Chairwoman STABENOW. Thank you.

Senator HOEVEN. Thank you, Madam Chairman.

Chairwoman STABENOW. You are welcome.

As we move to the second round of questions, I want to back up a bit and talk about one piece of this certainly that has become very clear about impact on the European debt situation. But we all know that there is potential devastating impacts on the global economy. In fact, today, I am hearing of serious impacts on our American automobile industry. I am sure we could speak about numerous other impacts in other parts of our economy. We remain

hopeful that a deal will be worked out, but I think we need to prepare for the worst.

So from your perspectives, what are your agencies doing to monitor the exposures of U.S. firms to these kinds of events? What are the ramifications of default or break-up of the Euro on the financial markets? And have you required firms with significant exposure to change their behavior? Chairman Gensler?

Mr. GENSLER. We are monitoring the events in Europe, but mostly through our conversations with other regulators at the FSOC and reading as much as we can, of course. Our primary focus has been on the clearinghouses, the largest amongst them in London and Chicago and Atlanta, I guess, and we have had in-depth meetings with them as to if shocks were to come out of Europe, how they would withstand those shocks, because it is always a best—that we hope for the best, to also plan for possible shocks.

We do not as an agency examine Futures Commission Merchants for their European exposures, but we do stay in communications with the Federal Reserve, the bank regulators, and the SEC with regard to the risks that they seek.

Chairwoman STABENOW. Chairman Schapiro.

Ms. SCHAPIRO. Yes. Well, we, of course, are also monitoring very closely the events in Europe, participating actively in the FSOC process where these issues are discussed really on a weekly if not more frequent basis. FINRA is also monitoring broker-dealer exposures to sovereign debt closely, and we are particularly focused at the SEC on the exposure of money market funds to European sovereign debt and stress testing that is going on in those funds to ensure that a default of the European sovereign or the commercial paper of a European bank might not cause a money market to break the buck, as happened during the financial crisis with Lehman paper, and create some severe consequences for money market fund investors.

Chairwoman STABENOW. Thank you.

Let me go back and talk a bit about audits. This has come up in a number of questions from colleagues and it certainly has come up as I have looked at the MF Global situation, where there is customer money missing, poor internal controls to prevent that from happening, which is, of course, absolutely unacceptable from the public standpoint, from a customer standpoint.

I have serious concerns that our system of audits and reviews is inadequate to identify and address the kinds of problems that are exemplified by MF Global. If the internal controls are as bad as some have indicated, it would be shocking, frankly, that, again, a company like this could have passed an audit, in the case of MF Global in the Spring of 2011. I have a question how that happened. How did they pass that audit?

So my question is, broadly, now, again, from a systems standpoint, are the scope and frequency of audits sufficient to understand the full exposures of companies? And again, use MF Global as an example of that. But the risks that they pose to the marketplace, should there not be a clean paper trail for companies like this? Chairman Schapiro.

Ms. SCHAPIRO. Sure. I cannot speak to the examination process on the futures side. I will say that we are very reliant on self-regu-

latory organizations on the securities side, as well. We have about 300 examiners for 5,000 broker-dealers, so we are very reliant on FINRA to do risk-based audits of firms, examinations.

But on the pure auditing side, Pricewaterhouse was the auditor for MF Global. We and the PCAOB, which is the direct regulator of auditing firms, the Public Company Accounting Oversight Board, are looking very closely at their role in this.

The other thing I would add, and I have mentioned already, is that we proposed in June an additional level of auditing for broker-dealer custody arrangements, and I would hope that the Commission will go ahead and finalize that rule shortly.

Chairwoman STABENOW. Chairman Gensler, broadly looking at this situation, what should be done on audits and accountability?

Mr. GENSLER. I am jealous when I hear that Chairman Schapiro has 300 examiners because I do not think we have 20. But audits are required once a year of the financials. I think we really have to look at whether there also should be an audit, a separate audit of the segregated accounts themselves and whether we should change that and enhance that rule. The examination function, we are reliant on the self-regulatory organizations. They do those examinations once every nine to 15 months under our guidance, but we do not participate in those examinations.

I think we need to really look as to whether there is enhancements and lessons learned. Again, others can—I will not participate. Others will come up with some of those working directly with the CME about the examination of this particular firm.

But more generally, how we as an agency can work with the self-regulatory organizations, frankly, with limited resources. I do not envision Congress is going to give us a lot more resources this year. We are advocating for them, but I have to be realistic, too.

Chairwoman STABENOW. So it does matter how many investigators, how many cops there are on the beat, even on the Wall Street beat.

Mr. GENSLER. In this case, it is how many accountants, but yes, it very much matters. We have 125 Futures Commission Merchants and 40 or 50 of them are large enough to be clearing members at the CME. We do not examine any of them. Can I repeat that?

Chairwoman STABENOW. Please do, although it is very concerning.

Mr. GENSLER. Yes. I mean, we do not examine any of them. That is not the system we have. We rely on self-regulatory organizations. We do some for-cause limited reviews, a handful a year. We are doing them right now actively on these top 12 to 14, as I earlier explained. But the front line is this reliance on self-regulatory organizations, and it has been for decades. That is not a change. And I think that it can work, but we have to really work with them to make it work.

Chairwoman STABENOW. Senator Roberts.

Senator ROBERTS. Thank you, Madam Chairman.

I am going to continue in regards to the line of questions that I had for the Chairman. The time line surrounding your statement of non-participation, I know everybody is talking about either recusing, stepping aside, or not participating. I am not too sure

what the difference is. Your response to my letters raises questions about who was in charge of CFTC's work in the early days of this event. I am talking, obviously, about MF Global.

According to your letter, you notified the General Counsel that you would not participate in enforcement matters. Why did you come to this realization on November 3? Had you not been participating in official CFTC actions regarding MF Global before this date?

Mr. GENSLER. As I mentioned, Senator, I had conversations directly with the General Counsel and through my staff with the Ethics Officer himself throughout those days and they had indicated that it was warranted for my involvement to stay participating. I indicated to the General Counsel on that Thursday that I thought that it could be a distraction to the very important work of pursuing where was the cash, where was the money, get the money back, and any investigation or enforcement matters.

Senator ROBERTS. Well, why would your participation be a distraction for that effort? Why?

Mr. GENSLER. Though I had not worked at the same firm in 14 years, and though I had not worked with the individual in nine years——

Senator ROBERTS. All right. You went over that. I am sorry.

Mr. GENSLER. I am sorry.

Senator ROBERTS. You jogged my memory. I think another question will help on that. Your statement of non-participation is dated November 8. My question obviously is, who was in charge between November 3, or you could go back to October 24, and November 8? Furthermore, Commissioner Sommers was not appointed the Senior Commissioner for this investigation until November 9. Who was steering the ship while you were deciding what you could and could not be involved in, or your attorney, or the Ethics Officer?

Mr. GENSLER. Well, as most things at the CFTC, we have talented staff, very excellent staff in the enforcement and other divisions——

Senator ROBERTS. So staff was in charge?

Mr. GENSLER. I—the reason it took until, if you can remind me, the 7th or 8th for me to sign a document is I——

Senator ROBERTS. It was November 8.

Mr. GENSLER. I thank you. I turned it over to the General Counsel that Thursday and said, if he could work through how to document this and to work with the other four Commissioners in terms of what would be the proper oversight moving forward.

Senator ROBERTS. Okay. A personal question. Why did it take you an additional 13 days and a follow-up letter from me to send your response on exactly what you are stating there?

Mr. GENSLER. Part of it is just the press of business at an agency like ours. I had hoped that there was enough communication——

Senator ROBERTS. Okay.

Mr. GENSLER. —but if there was not, I will try to work better to communicate with you personally and your office——

Senator ROBERTS. Okay, I appreciate that.

Mr. GENSLER. —more promptly.

Senator ROBERTS. Media reports say that you met with Mr. Corzine on Regulation 1.25. That is the regulation we are all talk-

ing about. Is this true? If yes, why did you not recuse yourself then?

Mr. GENSLER. As many, many companies have asked for phone calls or meetings, they asked for—it was actually a phone call in July of this year and we promptly put it on our website, as we have 1,100 other similar circumstances. But I was participating in the general rule writing as I was then and continue to participate in general rule writing.

Senator ROBERTS. Well, but did you meet with Mr. Corzine on Regulation 1.25?

Mr. GENSLER. Well, there was this phone call that staff and I participated in July.

Senator ROBERTS. I see. And you consider that a normal situation or business as usual, but now, since this has popped up, you have chosen to recuse yourself because of that, or the impression of that, or the perception of that, or——

Mr. GENSLER. No. It was really as of that Thursday of that week there had been a transition from a registrant had gone into bankruptcy and there was an ongoing investigative matter, and that Friday there was going to be an open surveillance meeting to discuss those matters, and I turned to General Counsel Berkovitz and asked him what I needed to do, and he said, you do not need to do anything different. And I said, let me tell you that I think it could be a distraction——

Senator ROBERTS. Well, it is now.

Mr. GENSLER. —to the very good work of the government.

Senator ROBERTS. I mean, if you determined that you met with Mr. Corzine on Regulation 1.25 and you know that in the back of your head, and then you say, well, from October 26 to November 8, and I am asking who is in charge and you are saying staff, and then all of a sudden it pops out of the woodwork that we are either stepping aside or we are not participating or we are recusing—and I still do not know what any of that means really. I do not understand why you just did not recuse.

Now you are going to have an investigation by Commissioner Sommers and the CFTC and this is going to drag on for a considerable amount of time until we find out really what happened to the money. And you have all sorts of conjecture in the press and the media about that and you are going to still be, what, non-participating? That just raises it up as a bigger distraction.

I think you should have probably just gone ahead and said, hey, I am the Chairman. I can make these decisions. But now you have said that you are non-participating. We had two regulatory questions and you said, "I am non-participating." That is a dodge, you know? That is not right. Can you clarify the Regulation 1.25 is not a Dodd-Frank prescribed regulation? In fact, did the CFTC not issue an Advance Notice of Proposed Rulemaking on Regulation 1.25 before Dodd-Frank was signed into law?

Mr. GENSLER. There is one component that relates to Dodd-Frank, but most of it is, you are right, is not necessarily Dodd-Frank. The one component is Dodd-Frank said we had to withdraw reliance on rating agencies in all of our rules, and that is a component of the 1.25 rule.

Senator ROBERTS. All right. As we go through this inquiry, or hearings here—not an investigation, but an inquiry, hearings, and I again thank the Chairwoman for her efforts in this regard—and I realize I am out of time, but I just—I am having a lot of trouble with your non-participation or recusal. Can you spell out the specific terms of your non-participation, or is it a recusal? I know you said you are going to step aside. And again, this is going to go on for quite some time and you are going to get an awful lot of questions and you are just going to say, "Well, I cannot answer that because I am non-participating." I think it would be better for you to say, "I am recused," or not being—or turn it around and say, "I made a mistake. I can answer these questions." Because now it is a distraction, Gary. Come on.

Mr. GENSLER. Senator, I am not participating in the matters, and the letter that you posted on your website, including the document of my non-participation, is of public record. I thank you for putting it on the website. I mean, I am not participating so that it is not a distraction to the hard working efforts of the staff on these matters, and that includes—the General Counsel will make determinations, but that includes the bankruptcy and the matters related to—the General Counsel was very clear with me that it would be broadly interpreted with regard to matters related to this company.

Senator ROBERTS. All right. I will take it at that.

Madam Chairman, I had just a couple of questions on the rulemaking, and I know that this has gone on for a long time and I think you have, as well.

Chairwoman STABENOW. Yes. We can do—Senator Klobuchar is here. We can——

Senator ROBERTS. Oh, I am sorry. I apologize to the Senator. My apologies.

Chairwoman STABENOW. No, no. That is okay. Thank you very much. We will, in fact, do another round, Senator Roberts, because I have additional questions, as well.

Senator Klobuchar.

Senator KLOBUCHAR. Very good. Thank you very much, Madam Chairman.

Getting a little broader here and the effect this is going to have in general on the markets, I am just looking at the fact that this is rural America, people like Dennis Magnuson, who is a pork producer in Austin, Minnesota, that were not directly—and even those that were not directly impacted in the agriculture community have serious concerns. And my question is, what do you see as the long-term economic consequences of the MF Global failure? We certainly saw long-term consequences with Lehman Brothers and other failures. Are you concerned that a lack of confidence regarding the security of segregated accounts could lead to a less predictable and more volatile commodities market?

Mr. GENSLER. I think it is critical for people, as you just mentioned—was it Dennis?—and others have confidence, because the economic welfare of Dennis and of America relies on people being able to protect themselves against price risk, as the price of corn or wheat or oil going up or down or interest rates going up or down, and focusing on what they really do best. And so I think we are all committed at the CFTC to ensuring in that confidence.

Firms will fail from time to time. We are not going to repeal that nature. Firms in every other field fail, not just the financial world fail. But what we have to ensure is when they fail, it does not become systemic, and when they fail, that the customers are protected and that the money and the segregation of that money is protected and it might be only invested in sort of a little bit boring stuff, but it is invested, you know, safely.

Senator KLOBUCHAR. We like boring stuff in our State.

There are a lot of questions, speaking of those damages, about the amount of the shortfall. The only public statement from the trustee has been $1.2 billion, almost double the early estimates that we heard from the CFTC and CME. Regardless of the number, we know there is going to be a shortfall. And I do not know if Commissioner Sommers can answer this, but what do you see as the legal recourse that the victims of this have?

Ms. SOMMERS. Senator, the process that is ongoing right now includes several different distributions of customer money back to the customers. It started with the transfer of the open positions that were on the exchanges. That happened first, along with the margin that supported those positions. Approximately 60 percent different for different customers transferred with those positions.

The next group of transfers that was approved by the court was cash only, people who did not have positions that had cash only at MF Global. They were given a distribution of approximately 60 percent.

Now there are a couple other groups of people, people who liquidated after this SIPC bankruptcy went into effect on the 31st. Those people who liquidated in between October 31 and the time of the transfers, those people were not covered in the first two distributions, so they will be included in a motion that the trustee just filed this week to true up everybody who has not received distributions so far, to true those accounts up to approximately two-thirds of what was in the account.

We are hopeful that we will be able to return all customer money to those customers, to make them whole. That is our goal and that is what we will be working with the trustee to make happen. What will probably happen after final distributions to true those accounts up is that all other claims will go through the formal claims process.

Senator KLOBUCHAR. All right. Well, I really hope you are hopeful in the right way, that this happens, because, obviously, people are very, very concerned about this, and they have heard that two-thirds number, but to get to the full reimbursement would obviously be our goal.

Several constituents have had questions about CME's $550 million guarantee, and I know you cannot speak for the Chicago Mercantile Exchange, but this guarantee certainly has a bearing on constituents. Can you discuss how this guarantee will work, because I know there is a lot of confusion. That will be my last question.

Ms. SOMMERS. My understanding of the guarantee is that if the trustee were to distribute approximately 66 percent of the money back to the customers and in the end find that the shortfall in the customer funds account is more than what they anticipated so that

they had actually distributed more than they should have back to customers, this guarantee fund would cover any shortfall in the money that the trustee may have given out too much.

Senator KLOBUCHAR. Right. So the extra money that we are looking for above the 66 percent, the two-thirds percent, they will have to find in other ways?

Ms. SOMMERS. Right. It would be—if the shortfall is found in the end to be more than 34 percent, that guarantee fund would cover anything above that.

Senator KLOBUCHAR. Okay. Thank you very much.

Ms. SOMMERS. Sure.

Chairwoman STABENOW. Thank you very much.

Chairman Gensler and Chairman Schapiro, a number of times today, we have heard conversations about having resources, and we certainly want you to manage the resources that you have in the most effective way possible and to stretch every dollar. But I think it is realistic and important and fair to look at over the years what has happened, particularly on the CFTC side when in the last ten years we have seen the volume of future trades increase 435 percent and the staff budget go up nine percent. So that certainly does not correlate. And when we add to that the Wall Street Reform effort and title VII on top of that, this has created a very difficult situation.

So I would appreciate both of you responding to the need for resources if we are going to truly oversee and protect markets and market integrity and market participants. We have seen calls to cut investigators and auditors in both of your agencies, and at the same time concerns are raised about customer protection, which is of great concern to me on behalf of the people I represent in Michigan and people I am hearing from in Michigan.

We are told that there is great concern about not doing enough to look after the markets, but then the same folks will suggest cutting the resources, and again, the cops on the beat, the folks that are the investigators, the auditors, whatever is needed in terms of protecting American customers and their interests.

Certainly MF Global is a stark reminder of the consequences if we play politics with agency resources, because, ultimately, we are talking about customers' money and hard working people. I have heard from farmers. I have heard from retirees, grain elevators, other business people. Obviously, folks want us to take this very seriously.

So I would like to ask each of you to respond to a level of funding that you believe you need to fully focus on the areas of concern that we have raised here in the committee. Chairman Gensler.

Mr. GENSLER. I thank you. I think this is a good investment for the American public. Our funding this year was just boosted from $202 to $205 million. The President's request for this year is for $308 million. And while our great nation is challenged by budget deficits, and so I appreciate that this is a hard request, taking on a market that is so vast and so complex as the swaps marketplace, I think it is in the order of probably, if it does not happen this year, I think it is going to be needed in the next two, three years to increase our funding about 40 to 50 percent.

Heavy emphasis on technology. Maybe it is technology goes up twice and staffing only goes up 30 to 40 percent. But we cannot send computers in front of judges, and you could not really have used a computer to do all the audits and examinations. I mean, we do need probably 30 to 40 percent more people.

Chairwoman STABENOW. Thank you.

Chairman Schapiro.

Ms. SCHAPIRO. Thank you. We are obviously a lot larger than the CFTC, but the scope of our responsibilities is really extraordinarily broad when you think about issues ranging from market structure, mutual funds, money market funds, accounting, transfer agents, exchanges, broker-dealers, and clearing agencies.

The President's request for the SEC for this fiscal year—we are under a continuing resolution still—was $1.4 billion. Our goal with that would be to expand our enforcement and examination efforts and our core responsibilities, but also be able to operationalize the rules that we are in the process of finalizing for over-the-counter derivatives, hedge funds—those rules are finalized, to bring hedge funds over regulation—municipal advisors, credit rating agencies, and others.

The one thing I think is important to note for the SEC is that we are deficit neutral. We have matched funding from industry fees and assessments that cover 100 percent of our appropriation. So depriving the SEC does not benefit other agencies in any way.

Chairwoman STABENOW. Thank you very much.

Finally, my last question, I cannot have both of you here and not talk about harmonizing rules, and so let me just ask, as you know, we in Congress require the agencies to consult and to coordinate, and I know that you are doing that, but we do have a lot of work left to do and then concerns that I have about really seeing that happen. The proposed rules are being released on separate time lines with significant differences in several key rules, notably swap execution facility rules. There are some differences certainly in commodities and securities markets, and having two separate systems, I understand there are differences, but it is really counterproductive, I think, and burdensome and simply makes market oversight tougher if we are not harmonizing definitions and rules and so on.

You have both testified in the past that you are working together. I know that you are doing that. But at this point, despite the fact that there are a number of issues that I know that are quite contentious and quite complicated, it is absolutely critical from the customer standpoint, again, the public standpoint, that you be harmonizing what you are doing.

So I would ask each of you, what are the greatest differences yet to be resolved between your two agencies and what final rules do you foresee being different in the future. Chairman Gensler.

Mr. GENSLER. Well, we are working very closely on the definitions rules, on who is a swap dealer, a securities-based swap dealer and what is a swap and securities-based swap. Frankly, in that area, we will have some differences because the issue of forwards is so much more important that we do not inadvertently bring in some transaction on grain or energy into the definition of swap and it does not relate as much. So there is a lot of technical things that

you will be happy we are doing, but there will be some differences, I think.

I think those two sets of definition rules, we really need to get out there, and the markets want to have that— lower that regulatory uncertainty.

The swap execution facility rules might be in that later stage. You know, it will not be in January, for instance. I mean, I think it will take us a number of months more, and we are going to try to continue to narrow any differences in there. But as you mentioned, there might still be some differences because the futures market and the securities markets do have some differences, but we are trying to work to get in that where we can.

Chairwoman STABENOW. Before Chairman Schapiro answers, I wonder if you might talk a little bit more specifically, though, about how close you are to finalizing the entity definitions and the product definitions, because those are really foundational rules, as you know, and important definitions that really need to be completed jointly.

Mr. GENSLER. Though I had been optimistic throughout the month of October and November that we might vote on the entity definition rule this month of December, just given the press of business at both of our agencies, we have a document between us that is very close and it is getting final review by the economists and others. But I think that rule could be calendered—I will see if Chairman Schapiro will shoot me or not—for early to mid-January if we could get that last bit of work done.

I think on the product side, we are a little bit behind because we only proposed that in April. Jointly, we proposed it in April. We have our comment summaries, our staff recommendations, and the two staffs are working on the actual document, but it may not be in front of Commissioners until January, which could then put off the vote for a little bit longer because Commissioners, of course, need to weigh in and deliberate, all ten Commissioners in this case.

Chairwoman STABENOW. Chairman Schapiro.

Ms. SCHAPIRO. I think that is a fair estimate for when we will be able to do the joint definitions. I think the effort right now is very much focused on the cost-benefit analysis and making sure it is as robust and thoughtful as it possibly can be.

More broadly, you know, there are differences, obviously, between our rules and the CFTC's rules, and Madam Chairwoman, as you point out, some of those distinctions or differences come about because of the distinctions between the products. Security-based swaps and swaps can be quite different. They have different liquidity characteristics, in some instances different trading characteristics.

But I think, also, each agency's respective concerns about arbitrage with our existing markets has driven some of the differences, as well, for the CFTC between the OTC derivatives and the regulated futures markets, for us, between the derivatives and the primary equity markets.

That said, I think that we have worked very well together. We are still trying to narrow differences where we can. I think the big differences really do come about in Reg SEF, the swap execution facilities, which we have defined basically multiple to multiple in

a different way. Around blocks, how to define block trades and the dissemination of block information to the marketplace is an area where we have some differences. There are some differences in the data elements for reporting between the two agencies. And then there are a number of other perhaps less significant ones.

And I think a lot needs to come together as we do our implementation releases and talk about how we plan to build and sequence the rollout of these rules.

Chairwoman STABENOW. Thank you very much.

Senator Roberts.

Senator ROBERTS. Thank you, Madam Chairwoman.

Chairman Gensler, at a previous hearing, I posed to you a simple question regarding bona fide hedges that involved, as you recall, a Kansas grain elevator, and I understand that prior to your vote on the position limits rule, there is a colloquy between you and former Commissioner Dunn on this topic and the final rule. Were you able to resolve this issue? Yes or no.

Mr. GENSLER. I think the answer is yes. We believe so.

Senator ROBERTS. So all the country elevators out in Kansas can now not worry about putting up on their silos that they are a hedge fund, or that they continue to be a country elevator and not a hedge fund?

Mr. GENSLER. They are country elevators.

Senator ROBERTS. All right. Thank you.

Chairman Schapiro, in July, the D.C. Circuit Court vacated your proxy rule based on your agency's to be determined cost-benefit analysis. Some in the media have called the court's opinion a stinging rebuke of the SEC's methodology. You have already spoken to that to some degree with the Chairman on what you intend to do. I have long been, as I think everybody on the committee has been, an advocate for honest evaluation of the costs and benefits of our government regulations. That is the number one issue that I get in Kansas regardless of the other things that we are facing.

What have you learned from this decision, and Chairman Gensler, how can other agencies like the CFTC learn from the court's decision?

Ms. SCHAPIRO. Thank you, Senator. We have learned from the decision. While we do not necessarily agree with all the court's reasoning or findings, we have taken it very much to heart. We have continued to build our economic capability at the agency. We have a new Chief Economist and he is recruiting additional economists to our staff.

We understand we need to better explain the choices that we make in our rulemaking and the costs and benefits of the different choices that we consider. We need to explain more effectively how we took commenters' views into consideration as we proceeded with rulemaking. We have incorporated our economists much earlier in the process and kept them well incorporated throughout the entire rulemaking process so they can be part and parcel of the team that develops any regulatory proposals. We are seeking more economic data when we publish for comment our rule proposals and we are trying to do—and we are doing analysis at both the proposing stage and at the final stage.

So we are really redoubling our efforts in terms of a more robust process, more analysis where possible, recognizing that these can be very challenging analyses to do in particular circumstances.

Senator ROBERTS. Well, the President issued an Executive Order clear back in January on this and another one in July and gave everybody, all independent agencies, 120 days to make a report. I do not know where yours is or that of the CFTC.

Chairman Gensler, do you have any comment?

Mr. GENSLER. We take the cost-benefit considerations very importantly. Our statute actually has a section, it is called 15a, but after the opinion to which you referred—I think it was in August—our Chief Economist and the lawyers all looked at that opinion and said, what do we need to do more? They produced yet another memo to all the team leads and to the Commissioners about that opinion. And so each of the rules that we are putting forward already had cost-benefit. We have vastly benefited from the public and their comments on this and we even hired a few more economists, as well, within the budget.

In terms of the President's Executive Order from January and July, though Section 15a does not exactly line up with the Executive Order, I think that it is consistent with the main themes of that Executive Order. And with regard to the 120-day review, we actually put something on our website. This was to review all of our former rules, anything in the rule book. We put something on our website to ask for public comment. I think we have actually—that comment period closed, where people sort of have come in and said, here are the things you should change in your former rules, and we need to do that, but we have not yet then gone back to revise the existing rulebook.

Senator ROBERTS. Thank you.

One final question, again, on your recusal. You indicated that staff, not a Senate-confirmed Commissioner, were in charge from November 3rd to November 8th. Can you tell us who ran the surveillance meeting on November 4th that you cited as a reason for stepping aside or being a non-participant on November 3rd?

Mr. GENSLER. I was not there, but—so, Senator, when I am not there, when any Chairman is not there at the CFTC, the staff reports to the other Commissioners. So at the surveillance meeting, it would have been the Senior Commissioner who was there that Friday morning who—and it was not the first surveillance meeting I was not at. I mean, there are times where matters come up and it is the senior person.

Senator ROBERTS. Sure. All right. Thank you.

Chairwoman STABENOW. Well, thank you very much to both of you, again, for coming in and being available to the committee.

I would just say for the notice of the members that additional questions for the record should be submitted to the clerk five business days from now, which is 5:00 on December 8.

Let me also indicate that I have submitted a number of significant questions for the record to both of you regarding MF Global and other Dodd-Frank related matters, including high-frequency trading, inter-affiliate transactions, small business broker exemption, a question that deals with important competitiveness issues like bundling of services for swap data, repositories and derivatives

clearing organizations, and I would appreciate prompt answers to all of these questions. We have a number of important questions that we would appreciate your answers to.

And to members of the committee, I would remind you that we will be holding a hearing on MF Global and the bankruptcy on December 13th in the morning.

Finally, let me just say that this is about, again, customers. This is about American citizens, farmers, ranchers, retirees in Michigan that have contacted me, cooperatives, grain elevators, anyone who needs the markets to hedge their risk and trusts that the system is going to work and that their money is going to be where they thought it was going to be. And so as we move forward, we are going to let the facts take us wherever they take us. This is very serious. We take our oversight responsibility very seriously and we intend to work together to make sure that the people get the answers that they need.

So thank you very much for being with us today.

[Whereupon, at 12:34 p.m., the committee was adjourned.]

A P P E N D I X

DECEMBER 1, 2011

Opening Statement
Senator Saxby Chambliss
Senate Committee on Agriculture, Nutrition & Forestry
Continuing Oversight of the Wall Street Reform and Consumer Protection Act
Thursday, December 1, 2011

Madam Chairwoman and Senator Roberts, thank you for providing this Committee the opportunity to again review the Wall Street Reform and Consumer Protection Act. I would also like to thank the witnesses for being here to both update us on the progress of their rulemaking process and to help us better understand the CFTC and the SEC's investigation into the collapse of MF Global.

In 2008 this Congress began a long and serious discussion about how best to protect the livelihood of those affected by our financial system. Everyone in this country has felt or is feeling some effect from the breakdown in our ability to regulate, enforce, and provide effective protection measures. The results of our efforts became the Dodd-Frank Wall Street Reform and Consumer Protection Act. I had many concerns about this legislation. The ability to secure our financial system and prevent the need for taxpayer bailouts led to legislation that I believe was overreaching and burdensome to some market participants that did not need additional regulation – these efforts will end up costing us more than we will benefit.

The CFTC will need to finish its rulemaking process for many of the principal measures of the Dodd-Frank law, including Designated Contract Markets, Swap Execution Facilities, and Foreign Boards of Trade. Further, the CFTC has announced their intention to consider rules to provide non-financial end users with exemptions from clearing. It is imperative that the CFTC provide a clear end user definition and subsequent protections to prevent these end users from having to bear the cost of compliance of unnecessary rules.

Even after all these rules, regulations, and red tape are put into place, I will remain concerned that those who caused the financial crisis will never be held accountable and the American financial system will not be any safer. As I have said before, this legislation and the regulations that will be created under the authority of the legislation have created massive uncertainty, opportunities for international regulatory arbitrage, unnecessary and imprudent use of capital, loss of market liquidity, as well as huge legal fees and giant costs related to compliance.

While some time has passed since the initial fallout of that crisis and the legislative response, we are still not immune to preventable wrongdoing in our financial system, nor are we free from the failure of financial firms. On October

31st of this year, MF Global, a major derivatives broker, failed and subsequently filed for bankruptcy. It is alleged that MF Global broke the absolutely unbreakable rule in the financial industry by backing their own trades with the money of their customers. It is up to regulators both at the SEC and the CFTC to determine what rules were broken.

In response to the MF Global situation, CFTC recently announced a scheduled vote on additional consumer protection rulemaking. CFTC's December 5th meeting will put in place new rules for the segregation of funds for cleared swaps, and additional protections for customers using clearinghouses and futures commission merchants when investing their funds. Chairman Gensler, I hope you will provide the committee with further information about this rulemaking.

I am discouraged by some media reports citing discrepancies between the SEC and the CFTC. It is imperative that regulators ensure efficient resolve and cooperation in the investigation phase of this case. More and more people in this country are becoming too familiar with the Securities Investor Protection Corporation process for resolving the failure of a firm due to improper conduct by the firm. I look forward to hearing from Chairman Gensler and Chairman

Schapiro regarding the combined processes these regulators are undertaking to resolve this failure for the affected customers of MF Global.

Finally, Mr. Gensler, I look forward to hearing from you about your decision to remove yourself from further investigatory proceedings on the MF Global situation. The Dodd-Frank bill gave CFTC more ability and authority to investigate and pursue offenders. I hope you will also elaborate on how these new authorities relate to your investigation of MF Global.

Again, I would like to thank the Chairwoman and ranking Member for holding this hearing and I look forward to the forthcoming testimonies.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

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

WASHINGTON, DC

December 1, 2011

Good morning Chairwoman Stabenow, Ranking Member Roberts and members of the Committee. I thank you for inviting me to today's hearing on implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC). I also thank my fellow Commissioners and CFTC staff for their hard work and commitment on implementing the legislation.

Lessons of 2008

Three years ago, the financial system failed, and the financial regulatory system failed as well. We are still feeling the aftershocks of these twin failures.

There are many lessons to be learned from the crisis. Foremost, when financial institutions fail, real people's lives are affected. More than eight million jobs were lost, and the unemployment rate remains stubbornly high. Millions of Americans lost their homes. Millions

more live in homes that are worth less than their mortgages. And millions of Americans continue struggling to make ends meet.

Second, it is only with the backing of the government and taxpayers that many financial institutions survived the 2008 crisis. A perverse outcome of this crisis may be that people in the markets believe that a handful of large financial firms will – if in trouble – have the backing of taxpayers. We can never ensure that all financial institutions will be safe from failure. Surely, some will fail in the future because that is the nature of markets and risk. When these challenges arise though, it is critical that taxpayers are not forced to pick up the bill – financial institutions must have the freedom to fail.

Third, high levels of debt – and particularly short-term funding at financial institutions – was at the core of the 2008 crisis. When market uncertainty grows, firms quickly find that their challenges in securing financing, so called problems of "liquidity," threaten their solvency.

Fourth, the financial system is very interconnected – both here at home and abroad. Sober evidence from 2008 was AIG's swaps affiliate, AIG Financial Products, which had its major operations in London. When it failed, U.S. taxpayers paid the price. We must ensure that Europe's ongoing debt crisis does not pose a similar risk to the U.S. economy.

Lastly, while the 2008 crisis had many causes, it is evident that swaps played a central role.

Swaps added leverage to the financial system with more risk being backed by less capital. They contributed, particularly through credit default swaps, to the bubble in the housing market. They contributed to a system where large financial institutions were considered not only too big to fail, but too interconnected to fail. Swaps – developed to help manage and lower risk for end-users – also concentrated and heightened risk in the financial system and to the public.

Dodd-Frank Reform

Congress and the President responded to the lessons of the 2008 crisis – they came together to pass the historic Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The law gave the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) oversight of the more than $300 trillion swaps market. That's over $20 of swaps for every dollar of goods and services produced in the U.S. economy. At such size and complexity, it is essential that these markets work for the benefit of the American public; that they are transparent, open and competitive; and that they do not allow excessive risk to spread through the economy.

The CFTC has benefited from significant public input throughout the rule-writing process. We have received more than 25,000 comment letters. CFTC staff and Commissioners have met more than 1,100 times with market participants and members of the public to discuss

the rules, and have held more than 600 meetings with domestic and foreign regulators. We also have conducted 14 public roundtables on Dodd-Frank, many of them with the SEC.

The CFTC has substantially completed the proposal phase of Dodd-Frank rules. We have held 20 public meetings and issued more than 50 proposed rules on the many important areas of reform called for by the new law, including transparency, lowering risk through clearing, market integrity and regulating swap dealers.

The agency turned the corner this summer and began finalizing rules to make the swaps marketplace more open and transparent for participants and safer for taxpayers. To date, we have finished 18 rules, and we have a full schedule of public meetings this month and into next year.

Promoting Transparency

The more transparent a marketplace is, the more liquid it is and the more competitive it is. When markets are open and transparent, prices are more competitive, markets are more efficient, and costs are lowered for companies and their customers. Transparency benefits the entire economy.

To increase market transparency, we have completed rules that, for the first time, provide a detailed and up-to-date view of the physical commodity swaps markets so regulators can police for fraud, manipulation and other abuses. The large trader reporting rule we finalized establishes

that clearinghouses and swap dealers must report to the CFTC information about large trader activity in the physical commodity swaps markets. The rule went into effect November 21. For decades, the American public has benefitted from the Commission's gathering of large trader data in the futures market, and now will benefit from the CFTC's new ability to monitor swaps markets for agricultural, energy and metal products.

We also finished a rule, which became effective October 31, establishing registration and regulatory requirements for Swap Data Repositories, which will gather data on all swaps transactions. By contrast, in the fall of 2008, there was no required reporting about swaps trading.

Moving forward, we are working to finish rules relating to the specific data that will have to be reported to the CFTC. These reforms will provide the Commission with a comprehensive view of the entire swaps market, furthering our ability to monitor market participants and to protect against systemic risk.

We also are looking to soon finalize real-time reporting rules, which will give the public critical information on transactions – similar to what has been working for decades in the securities and futures markets.

In addition, we are working on final regulations for trading platforms, such as Designated Contract Markets, Swap Execution Facilities and Foreign Boards of Trade – all of which will

help make the swaps market more open and transparent. The Foreign Boards of Trade rule will be considered at our next Commission meeting December 5.

Lowering Risk Through Clearing

Another significant Dodd-Frank reform is lowering risk to the economy by mandating central clearing of standardized swaps. Centralized clearing will protect banks and their customers from the risk of a default by one of the parties to a swap. Clearinghouses reduce the interconnectedness between financial entities. They have lowered risk for the public in the futures markets since the late 19th century. Last month, we finalized a significant rule establishing risk management and other regulatory requirements for derivatives clearing organizations.

On December 5, the CFTC will consider a final rule that will enhance customer protections regarding where clearinghouses and futures commission merchants can invest customer funds. We also are looking to soon finalize a rule on segregation for cleared swaps. Segregation of funds is the core foundation of customer protection. Both of these rules are critical for the safeguarding of customer funds.

In addition, after the first of the year, we hope to consider finalizing rules that will broaden access to the markets, including straight-through processing, or sending transactions immediately to the clearinghouse upon execution; and the exemption for non-financial end users. The Dodd-Frank Act does not require non-financial end-users that are using swaps to hedge or

mitigate commercial risk to bring their swaps into central clearing. The law leaves that decision to individual end-users. In addition, the CFTC's proposal on margin states that non-financial end-users will not be required to post margin for their uncleared swaps. Lastly, the Dodd-Frank Act maintains a company's ability to hedge particularized risk through customized transactions.

Market Integrity

To enhance market integrity, we finished an important rule Congress included in the Dodd-Frank Act giving the Commission more authority to effectively prosecute wrongdoers who recklessly manipulate the markets. The rule, which went into effect August 15, broadens the types of enforcement cases the Commission can pursue and improves the agency's chances of prevailing over wrongdoers. The new authority expands the CFTC's arsenal of enforcement tools so the Commission can be a more effective cop on the beat.

We also finalized a rule to reward whistleblowers for their help in catching fraud, manipulation and other misconduct in the financial markets, which will enhance our ability to protect the public. It went into effect October 24.

In addition, we recently completed speculative position limit rules that, for the first time, limit aggregate positions in the futures and swaps market.

To further enhance market integrity, we are looking to finalize guidance on disruptive trading practices, as well as regulations for trading platforms.

Regulating Dealers

It is also crucial that swap dealers are comprehensively regulated to protect their customers and lower risk to taxpayers.

The CFTC is working closely with the SEC and other regulators to finalize a rule further defining the term swap dealer. We also are planning to finalize a rule on the registration process for swap dealers and major swap participants. The agency is looking to soon consider final external business conduct rules to establish and enforce robust sales practices in the swaps markets. We also will consider final internal business conduct rules, which will lower the risk that dealers pose to the economy. In addition, we have been working closely with other regulators, both domestic and international, on capital and margin rules.

Implementation Phasing

The CFTC has reached out broadly on what we call "phasing of implementation," which is the timeline that our rules will take effect for various market participants. We held a roundtable with the SEC in May to hear directly from the public about the timing of implementation. Prior to the roundtable, CFTC staff released a document that set forth concepts the Commission may consider on effective dates of final rules, and we offered a 60-day public comment file to hear specifically on this issue. The roundtable and public comment letters

helped inform the Commission as to what requirements can be met sooner and which ones will take a bit more time.

In September, the Commission issued for public comment a proposal for phasing in compliance with the swap clearing and trading mandates. We also proposed an implementation schedule for previously proposed rules on swap trading documentation requirements and margin requirements for uncleared swaps. These proposals are designed to smooth the transition from an unregulated market structure to a safer market structure. As we progress in finishing major rules, we will continue looking at appropriate timing for compliance, which balances the Commission's desire to protect the public while providing adequate time for industry to comply with these new rules.

In addition, much like we did on July 14, we will soon consider further exemptive relief regarding the effective dates of certain Dodd-Frank Act provisions. Commission staff is working very closely with the SEC on rules relating to entity and product definitions. Staff is making great progress, and we anticipate taking up the further definition of entities in the near term and product definitions shortly thereafter. As these definitional rulemakings have yet to be finalized, the order would provide relief beyond December 31, 2011.

International Coordination

The global nature of the swaps markets makes it imperative that the United States consults and coordinates with foreign authorities. The Commission is actively communicating

internationally to promote robust and consistent standards and avoid conflicting requirements, wherever possible. CFTC staff is sharing many of our comment summaries and drafts of final rules with international regulators. We are engaged in bilateral discussions with foreign authorities, and have ongoing dialogues with regulators in the European Union (EU), Japan, Hong Kong, Singapore and Canada. On December 8, Chairman Schapiro, and I will meet with the CFTC's counterparts from these four countries and the EU to discuss how to regulate the global swaps market in a consistent, comprehensive and coordinated manner.

The Commission also participates in numerous international working groups regarding swaps, including the International Organization of Securities Commissions Task Force on OTC Derivatives, which the CFTC co-chairs. In August, the CFTC and SEC staff held a daylong, joint roundtable to discuss international issues related to implementation of Title VII of the Dodd-Frank Act. I anticipate that the Commission will explicitly seek public input on the extraterritorial application of Title VII of the Dodd-Frank Act.

Resources

As the CFTC finalizes these Dodd-Frank rules, the agency will need additional resources consistent with the CFTC's significantly expanded mission and scope. The swaps market is seven times the size of the futures market that we currently oversee.

The agency has the necessary funding to complete rules called for in the Dodd-Frank Act. Moving forward though, with seven times the population to police, the CFTC will need greater

resources to protect the public. Without sufficient funding for the Commission, the nation cannot be assured that this agency can oversee the swaps market and enforce rules that promote transparency, lower risk and protect against another crisis.

Conclusion

The CFTC is working to complete our rule-writing under the Dodd-Frank Act thoughtfully – not against a clock.

But until the agency implements and enforces these new rules, the public remains unprotected.

This is why the CFTC is working so hard to ensure that swaps-market reforms promote more open and transparent markets, lower costs for companies and their customers, and protect taxpayers.

Thank you, and I would be happy to take questions.

Testimony on Dodd-Frank Act Implementation
by
Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission

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

December 1, 2011

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

Thank you for inviting me to testify today regarding the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act") by the Securities and Exchange Commission ("SEC").[1] As you know, Title VII primarily relates to the regulation of over-the-counter ("OTC") derivatives, creates an entirely new regulatory regime for OTC derivatives, and directs the SEC to write a large number of rules necessary to implement the Act. Since its enactment in July 2010, the SEC has proposed more than three-fourths of the rules required by the Act. While we have accomplished much over the last year and a half, we are continuing to work diligently to implement all provisions of Title VII.

My testimony today will focus on the SEC's efforts to implement Title VII of the Dodd-Frank Act since its enactment.

Background

OTC Derivatives Marketplace

As I have testified previously before this Committee, the growth of the OTC derivatives marketplace has been dramatic over the past three decades. From its beginnings in the early 1980s, when the first swap agreements were negotiated, the notional value of these markets has grown to over $700 trillion globally.[2] However, OTC derivatives were largely excluded from the financial regulatory framework by the Commodity Futures Modernization Act of 2000. As a securities and capital markets regulator, the SEC has been particularly concerned about OTC derivatives products that are related to, or based on, securities or securities issuers, and as such are connected with the markets the SEC is charged with overseeing.

Dodd-Frank Act

Title VII of the Dodd-Frank Act mandates the oversight of the OTC derivatives marketplace and requires that the SEC and Commodity Futures Trading Commission ("CFTC") write rules that

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[1] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.
[2] See Bank for Int'l Settlements, OTC derivatives market activity in the first half of 2011 (November 2011) at 1, available at http://www.bis.org/publ/otc_hy1111.pdf (noting that total notional amounts outstanding of OTC derivatives rose by 18% in the first half of 2011, reaching $708 trillion by the end of June 2011).

address, among other things, mandatory clearing, the operation of security-based swap and swap execution facilities and data repositories, capital and margin requirements and business conduct standards for security-based swap and swap dealers and major participants, and regulatory access to and public transparency for information regarding security-based swap and swap transactions. This series of rulemakings is designed to improve transparency and facilitate the centralized clearing of security-based swaps, helping, among other things, to reduce counterparty risk. It should also enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based swaps. By promoting transparency, efficiency, and stability, this framework should help foster a more nimble and competitive market.

Public Consultation

The implementation of Title VII is a substantial undertaking and raises a number of challenges. Accordingly, we have been engaging in an open and transparent implementation process, seeking input on the various rulemakings from interested parties even before issuing formal rule proposals. As we complete the rule proposal phase and move into the rule adoption phase of implementation, we will continue to seek input on each rule proposal with the goal of producing effective and workable regulation of derivatives activities.

In addition, our staff has sought the views of affected stakeholders through meetings with a broad cross-section of interested parties. To further this public outreach effort, the SEC staff has held a number of joint public roundtables and hearings with the CFTC staff on select key topics. Through these processes, we have received a wide variety of views and information that is useful to us in proposing and, ultimately, adopting rules that are appropriate for these markets.

Ongoing Regulatory Coordination with the CFTC and Other Regulators

In implementing Title VII, our staff is in regular contact, both formal and informal, with the staffs of the CFTC, Federal Reserve Board, and other financial regulators. In particular, SEC staff has consulted and coordinated extensively with CFTC staff in the development of the proposed rules arising under Title VII, including joint rules further defining key terms relating to the products covered by Title VII and certain categories of market intermediaries and participants. Although the timing and sequencing of the CFTC's and SEC's proposed rules vary, they are the subject of extensive interagency discussions and, to the extent practicable, a coordinated approach. As we move toward adoption, the objective of consistent and comparable requirements will continue to guide our efforts.

The Dodd-Frank Act also specifically requires that the SEC, the CFTC, and the prudential regulators "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards" with respect to the regulation of OTC derivatives. Accordingly, the SEC has actively entered into bilateral and multilateral discussions with foreign regulators addressing the regulation of OTC derivatives. Through these discussions and our participation in various international task forces and working groups, we have gathered information about foreign regulatory reform efforts, identified potential gaps, overlaps and conflicts between U.S. and foreign regulatory regimes, and encouraged foreign regulators to

develop rules and standards complementary to our own under the Dodd-Frank Act. Such efforts include frequent calls and meetings with the European Union and other major foreign regulatory jurisdictions in Asia and North America. In addition, the SEC participates in the Financial Stability Board's Working Group on OTC Derivatives Regulation, of which the SEC serves as one of the co-chairs on behalf of the International Organization of Securities Commissions ("IOSCO"), and serves as one of the four co-chairs of the IOSCO Task Force on OTC Derivatives Regulation. In addition, we are convening, with the CFTC and European Securities and Markets Authority ("ESMA"), a meeting next week of international regulators to talk through the status of derivatives regulation implementation and cross border issues.

As we progress toward the adoption of our Title VII rules, we will continue to consult with our regulatory counterparts abroad in an effort to foster the development of common frameworks, and to help ensure a level playing field for market participants and prevent opportunities for regulatory arbitrage.

Title VII Implementation to Date

The SEC has taken significant steps in implementing Title VII of the Act, proposing rules in thirteen areas.

Initially, we proposed rules to mitigate conflicts of interest involving security-based swaps. These proposed rules seek to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

We then proposed anti-fraud and anti-manipulation rules for security-based swaps that would subject market conduct in connection with the offer, purchase, or sale of any security-based swap to the same general anti-fraud provisions that apply to all securities and reach misconduct in connection with ongoing payments and deliveries under a security-based swap. We also proposed rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps. Those rules lay out who must report security-based swap transactions, what information must be reported, and where and when it must be reported. In addition, we have proposed rules regarding the obligations of security-based swap data repositories, which would require security-based swap data repositories to register with the SEC and specify other requirements with which security-based swap data repositories must comply.

Thereafter, we proposed rules relating to mandatory clearing of security-based swaps. These rules would set out the way in which clearing agencies would provide information to the SEC about security-based swaps that the clearing agencies plan to accept for clearing. We also proposed rules relating to the exception to the mandatory clearing requirement for end users. These rules would specify the steps that end users must follow, as required under the Act, to notify the SEC of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement. In addition, we proposed joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and major security-based swap participants. These rules lay out

objective criteria for these definitions and are a first step in helping the SEC appropriately address the market impacts and potential risks posed by these entities.

More recently, we have proposed rules regarding the confirmation of security-based swap transactions, which would govern the way in which certain security-based swap transactions are acknowledged and verified by the parties who enter into them. We also proposed rules regarding the registration and regulation of security-based swap execution facilities, which would define security-based swap execution facilities, specify their registration requirements, and establish the duties and core principles for security-based swap execution facilities specified in the Act. These rules are focused on moving the trading of security-based swaps onto these newly regulated trading platforms, which are intended to provide more transparency and reduce systemic risk within the security-based swaps market.

In addition, we proposed rules to establish minimum standards concerning the operation, governance, and risk management of clearing agencies. At the same time, we reopened the comment period for our earlier proposal regarding conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

We also proposed joint rules with the CFTC regarding further definitions of the terms "swap", "security-based swap", and "security-based swap agreement" and proposed rules regarding the regulation of mixed swaps and books and records for security-based swap agreements.

We then proposed rules that would impose certain minimum business conduct standards upon security-based swap dealers and major security-based swap participants when those parties engage in security-based swap transactions. The proposed rules include business conduct standards arising in connection with security-based swap dealers' and major security-based swap participants' dealings with "special entities", which include municipalities, pension plans, endowments, and similar entities.

Most recently, we proposed rules that establish the process by which security-based swap dealers and major security-based swap participants must register with the SEC.

In addition, we adopted an interim final rule in October 2010 regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act. This interim final rule notifies certain security-based swap dealers and other parties of the need to preserve and report to the SEC or a registered security-based swap data repository certain information pertaining to any security-based swap entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

In order to facilitate the clearing of security-based swaps, the SEC also proposed rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions. We also readopted certain of our beneficial ownership rules to preserve their application to persons who purchase or sell security-based swaps.

Moreover, the SEC has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of the final rules arising under Title VII not having been enacted by the July 16, 2011 effective date of Title VII. Specifically, we:

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the July 16, 2011 effective date and provided temporary relief from several of these provisions;
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank Act provisions that would otherwise have applied to security-based swaps on July 16; and
- Took other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties.

Next Steps for the Implementation of Title VII

While the SEC has made significant progress to date, much remains to be done to fully implement Title VII. First, we need to complete the core elements of our proposal phase, focusing in particular on rules related to the financial responsibility of security-based swap dealers and major security-based swap participants.

In addition, because the OTC derivatives market is a global market, we will continue to evaluate carefully the international implications of Title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single rule proposal. The publication of such a proposal will give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties. The comprehensive and detailed dialogues we have had with the European Union and other major jurisdictions described earlier have informed our thinking about how to address the international implications of Title VII.

After proposing all of the key rules under Title VII, we intend to seek public comment on an implementation plan that will facilitate a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets. Many market participants have advocated that the SEC adopt a phased-in approach, whereby compliance with Title VII's requirements would be sequenced in an appropriate manner. We are actively engaged in developing an implementation proposal that takes into consideration market participants' recommendations with regard to such sequencing.

Impact of Rulemaking on Existing Markets and Competitiveness

There are unique challenges involved in imposing a comprehensive regulatory regime on existing markets, particularly ones that until now have been almost completely unregulated. In doing so, we have been considering the potential impact of Title VII's rules on the global competitiveness of U.S. companies. U.S. markets have been global leaders in part because of a

legal framework that promotes firms and markets that are a benchmark for strength, resilience and transparency.

To this end, we have been carefully considering the potential impact of Title VII's requirements upon the ability of U.S. market participants to compete effectively with foreign market participants that may not be subject to the Dodd-Frank Act. One area where these issues arise acutely is in the differing margin standards for U.S. and foreign market participants, where U.S. regulators seek strong standards to maximize safety and soundness, but U.S. firms are concerned that these rules could place their overseas operations at a competitive disadvantage to foreign-owned firms that meet different standards. To address these and other issues, U.S. regulators are working closely with foreign regulators, as noted above, to adopt consistent approaches to the regulation of the OTC derivatives market that will reduce risk more broadly and address competitiveness concerns.

Conclusion

The Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace and fulfill our mission to protect investors, maintain fair, orderly, and efficient markets, promote the prompt and accurate clearance and settlement of securities transactions, and facilitate capital formation. As we proceed with implementation of Title VII, we look forward to continuing to work closely with Congress, our fellow regulators, and members of the financial and investing public. Thank you for inviting me to share with you our progress on the implementation of Title VII. I look forward to answering your questions.

QUESTIONS AND ANSWERS

DECEMBER 1, 2011

Senate Committee on Agriculture, Nutrition & Forestry
Continuing Oversight of the Wall Street Reform and Consumer Protection Act
December 1, 2011
Questions for the Record
Chairman Gary Gensler

Chairwoman Debbie Stabenow

1) The CFTC's final rule for Swap Data Repositories (SDRs) prohibited SDRs from bundling mandated services with ancillary services. Congress was clear about its support for competition in the swaps marketplace, and I applaud any efforts to that end. I have heard concerns that the rules for Derivatives Clearing Organizations (DCOs) may not incorporate this same dedication to competition particularly as it pertains to bundling. Does the CFTC intend to treat SDRs and DCOs differently on the bundling issue? If so, is there a reason for this?

Response: For DCOs that also choose to register and serve as SDRs, the anti-bundling provisions in the SDR final rule will apply.

3) There is an ongoing debate about high frequency trading (HFT), what value it provides to the markets, and whether it contributes to market volatility. We all have an obligation to monitor market innovations and make sure that the markets are sufficiently protected. Does High Frequency Trading aid in price discovery, contribute to capital formation, or provide liquidity to the market? Does it have any potential to harm market participants? Should high frequency traders register with regulators? Would the CFTC have the resources necessary to oversee high-frequency traders?

Response: I expect the Commission to consider a release seeking public comment on imposing requirements on registered entities and futures commission merchants related to the electronic trading systems used by traders with direct market access, including high frequency traders. The release would seek comment on the merits of requiring that certain Commission-regulated entities impose a framework for electronic trading systems' testing and supervision and on various testing and supervision methods and the potential benefits, costs, effects, and risks associated with electronic trading.

4) Self-regulatory organizations play an important role in regulating the futures markets. Has there ever been an instance where the CFTC has stepped in and asked an SRO to do more to fulfill its regulatory responsibilities or to protect the futures markets and been explicit in doing so? Can you cite an example? Also, should there be a regulatory separation between a commercial entity that acts as a regulator and its regulated customers when the entity also relies on those regulated customers' activities for its revenues?

<u>Response</u>: The Commission's Division of Market Oversight (DMO) conducts rule enforcement reviews of exchanges. In any such review, staff evaluates the exchange's self-regulatory programs to ascertain compliance with the core principles. Staff also reviews the exchange regulatory staff, exchange procedures and work products relating to compliance with the core principles under review, the technology employed to conduct surveillance and oversight, as well as reviews of exchange staff logs and files related to investigations. After conducting a detailed analysis of collected information, staff prepares a report with recommendations for improvement if any shortcomings are identified. DMO's rule enforcement review reports are publicly available on the Commission's website.

An example is a recent rule enforcement review of the New York Mercantile Exchange (NYMEX), in which staff made a number of recommendations regarding the exchange's structure and regulatory program.

To safeguard against conflicts of interest that can arise between a DCM's self-regulatory responsibilities and its commercial business interests, the Commission promotes governance structural safeguards to be adopted by all DCMs. The Commission has sought public comment on proposed rules that would require 35% of a DCM's Board of Directors to be public directors. The proposed rules also would require each DCM to have a nominating committee and one or more disciplinary panels. Each DCM would also be required to have a regulatory oversight committee and a membership or participation committee, also subject to specific composition requirements. The Commission will thoroughly and carefully review submitted public comments before proceeding to consider final rules.

The Commission's Division of Swap Dealer and Intermediary Oversight reviews the financial surveillance programs of self-regulatory organizations. These reviews include an assessment of staffing levels and training programs. The reviews also focus on the self-regulatory organizations' programs for examining monthly unaudited and annual audited financial statements submitted by futures commission merchants, and the self-regulatory organizations' onsite examinations of FCMs to monitor for compliance with the Commission's minimum capital and customer funds protection requirements.

During the course of these reviews, CFTC staff develop recommendations to enhance the oversight programs. The recommendations are discussed with the organization's management and implementation of program changes are reviewed by CFTC staff.

6) Dodd-Frank made changes to the core principles for Designated Contract Markets (DCMs), including a change that requires DCMs to "protect the price discovery process of trading in the centralized market of a board of trade." Protecting the price discovery process is core to the Commission's mission. I have questions about your interpretation of this important core principle. I understand that the CFTC proposed a rule mandating a certain level of trading must occur on the centralized market. This rule states that if that mandate isn't met, a futures

exchange must delist that contract and transfer open positions to a swap execution facility (SEF) if they wish to continue offering such a contract. What problems relevant to the "price discovery process" existed prior to this rule that the CFTC is trying to address? What will the impact of this rule be specifically on smaller exchanges? Do you have any concerns that they will not be able to meet thresholds set in the proposed rule?

Response: The Dodd-Frank Act amended Core Principle 9 to require, among other things, that a board of trade must provide a competitive, open and efficient market and mechanism for executing transactions "that protects the price discovery process of trading in the centralized market of the board of trade." The Commission's proposed rule provides for permissible off-exchange transactions, but only to the extent that such transactions do not compromise the price discovery process of trading in the centralized market. Under the proposal, if off-exchange transactions become the exclusive or predominant method of establishing or offsetting positions in a particular market, the price discovery process in the centralized market will be jeopardized.

While all DCMs, both large and small, would be required under the proposed rule to monitor the trading volume of contracts that are listed on their facility, the centralized market trading requirement is not expected to have a disproportionate effect on smaller DCMs because the centralized market trading requirement is based on the total trading volume in the contract on the individual facility.
The Commission will thoroughly and carefully review submitted public comments before proceeding to consider final rules.

7) I have heard concerns from coops that the rules proposed in Dodd-Frank are being drafted without sufficient clarity. I encourage the Commission to do everything in its power to ensure that the rules are clear and the requisite compliance is readily apparent. I am particularly concerned about small businesses and commercial end users who do not have the legal staff or resources to wade through thousands of pages of new rules. These are good companies committed to compliance and following the rules, but are concerned they will inadvertently do something "unlawful," when they enter into everyday commercial contracts. Will you commit to ensuring that any new rules under Dodd-Frank, such as the definition of a swap, are sufficiently clear and that you will provide sufficient time after the final rules are published for compliance?

Response: The joint CFTC-SEC proposed rule to further define the terms "swap," "security-based swap," "mixed swap" and "security-based swap agreement" was published in the Federal Register on May 23, 2011. The Commissions have benefitted greatly from substantial public comment in regard to the rulemaking, including from many end-users. It is my hope that the Commissions will move forward shortly on the final joint rule.

Ranking Member Pat Roberts

2) You have testified here again today that you are coordinating on the rulemaking process. Is this just for joint rulemaking? Which rules are going to be jointly considered?

If indeed you are collaborating, then please describe the rationale for the agencies' divergent rules on:

a) Swap Execution Facility (SEF) rules: The CFTC is requiring quotes from at least 5 liquidity providers, while the SEC takes a more reasonable approach in allowing the customer to choose the number of quotes; and

Response: The CFTC's proposed SEF rule will provide all market participants with the ability to execute or trade with other market participants. It will afford market participants the ability to make firm bids or offers to all other market participants. It also will allow them to make indications of interest – or what is often referred to as "indicative quotes" – to other participants. Furthermore, it will allow participants to request quotes from other market participants. These methods will provide hedgers, investors and Main Street businesses both the flexibility to execute and trade by a number of methods, but also the benefits of transparency and more market competition. The proposed rule's approach is designed to implement Congress' mandates for transparency and competition where multiple market participants can communicate with one another and gain the benefit of a competitive and transparent price discovery process.

The proposal also allows participants to issue requests for quotes, whereby they would reach out to a minimum number of other market participants for quotes. For block transactions, swap transactions involving non-financial end-users, swaps that are not "made available for trading" and bilateral transactions, it allows market participants to get the benefits of the swap execution facilities' greater transparency, or they would still be allowed to execute by voice or other means of trading.

In the futures world, the law and historical precedent is that all transactions are conducted on exchanges, yet in the swaps world many contracts are transacted bilaterally. While the CFTC will continue to coordinate with the SEC to harmonize approaches, the CFTC also will consider matters associated with regulatory arbitrage between futures and swaps. The Commission has received public comments on its SEF rule and will move forward to consider a final rule only after staff has had the opportunity to analyze them and after Commissioners are able to discuss them and provide feedback to staff.

b) Real time reporting requirements where each agency is proposing different definitions of what "real time" means, definitions and reporting requirements for block trades, the

number of data fields that must be reported and which entity is tasked with submitting trade information to the public.

Response: Throughout the rulemaking process, the SEC and CFTC have worked to harmonize rules where appropriate. However, there are areas where differences in products require different regulatory treatment.

The CFTC definition of "real-time" is intended to be flexible and to take into account the nature of the reporting entity and the prevalence of technology by comparable reporting entities. For example, an end-user might not be expected to meet the same reporting time requirements that a SEF or DCM would be expected to meet.

The final real-time reporting rule did not address block trades. In light of comments it received, the Commission believed that it was prudent to re-propose rules for determining the appropriate minimum block trade size and to establish appropriate reporting delays for block trades. As for the number of data fields to be reported, the assets and instruments underlying commodity swaps are often more diverse than those underlying equity-based swaps and single-name CDS, which are relatively standardized. With respect to the entity responsible for making trade information public, the final CFTC rule is consistent with the SEC's proposal. Specifically SDRs will bear that responsibility.

3) Can you assure this committee that important congressionally-mandated joint rules, such as product and entity definitions, will in fact be issued jointly?

Response: Yes.

4) What is your opinion of the Crapo Amendment offered during the Senate Agricultural Appropriations debate?

One of the points made by Senator Crapo's Amendment is that it would seem logical to define certain key terms prior to finalizing other rules or heading overseas to impose our will on others. For instance, what is a swap contract, who is a swap dealer and who will be defined as major swap participants? Are you in a position to be able to enlighten us on when these seemingly fundamental questions will be answered?

Response: On April 18, the CFTC and the SEC completed rules to further define the terms swap dealer, major swap participant and eligible contract participant. The two Commissions are working on the second of two key joint definition rules to further define the terms "swap" and "security-based swap." The CFTC and SEC have jointly proposed the rule, have analyzed public comments, and are working to complete a document for final consideration.

5) We seem to be having difficulty right now with some of our most basic core competencies of market regulation yet you're intending to oversee the complex OTC market, not just in the United States, but overseas? What assurances do you have that overseas jurisdictions will follow our approach? How can you convince us that we won't see American firms lose business to foreign competitors over these regulations once they are in place? Has anyone analyzed the cost of applying Title VII overseas?

Have your agencies entered into any memoranda of understanding with foreign regulators that assure that their approach will not materially differ from the new rules regime we apply? Are there any assurances that you can point to other than to say "trust me?"

Response: In implementing the Dodd-Frank Act, the Commission has sought to obtain the views of the entire spectrum of market participants and regulators. The Commission and its staff have worked extensively with fellow domestic and foreign regulators to ensure coordination and cooperation to the maximum degree practical. As we do with domestic regulators, we are sharing many of our memos, term sheets and draft work product with international regulators. We have been consulting directly and sharing documentation with the European Commission, the European Central Bank, the UK Financial Services Authority, the European Securities and Markets Authority, the Japanese Financial Services authority, and regulators in Canada, France, Germany and Switzerland. The Commission's rulemaking process has benefitted greatly from the feedback of foreign authorities. Ongoing consultation has contributed in particular to efforts on rulemakings regarding designated clearing organization core principles, systemically important designated clearing organizations, registration requirements for foreign boards of trade, and data recordkeeping and reporting rules.

Regulators across the globe continue to work together towards achieving common goals, including the G-20 agreement of September 2009 that: all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by the end of 2012 at the latest. OTC derivative contracts should be reported to trade repositories. And non-centrally cleared contracts should be subject to higher capital requirements.

The swaps market is global and interconnected, which makes it imperative that the United States consult and coordinate with foreign authorities. The Commission is actively communicating internationally to promote robust and consistent standards and avoid conflicting requirements, wherever possible. The Commission participates in numerous international working groups regarding swaps, including the International Organization of Securities Commissions Task Force on OTC Derivatives, which the CFTC co-chairs. The CFTC, SEC, European Commission and European Securities Market Authority are intensifying discussions through a technical working group. The Commission also has developed a bilateral dialogue on OTC derivatives with other jurisdictions including Hong Kong, Singapore, Japan, and Canada. Discussions have focused on the details of the rules, including mandatory clearing, trading, reporting and regulation of derivatives market intermediaries. This collaboration is intended to bring consistency to oversight of the swaps markets.

Although we have not yet entered into new MOUs with foreign regulators, we do anticipate that it will be prudent to do so in order to facilitate coordinated supervision. I also anticipate the Commission will explicitly seek public input on the cross-border application of Title VII.

Senator Saxby Chambliss

1) While I can see that there might be some justification for differences in rules from the CFTC and SEC related to different products, there is no justification for how US law should be applied abroad.

Why are the CFTC and SEC not writing a joint rule on the extraterritorial application of Title VII?

Response: The SEC and CFTC are subject to divergent cross-border jurisdiction statutory provisions under Title VII. Even so, the SEC and CFTC will coordinate on the cross-border issues, consistent with the particular statutory provision applicable to each agency.

2) Has the CFTC performed an analysis of the cost of applying Title VII overseas?

Response: Staff is continuing to develop proposed guidance regarding cross-border issues. The Commission will provide the public with an opportunity to comment on the proposed guidance. The Commission will appreciate any information that commenters are able to provide regarding costs associated with implementation.

3) Why did the final position limit rule require hard position limits as opposed to position accountability levels for CERTAIN excluded commodities, such as interest rates and security indexes, even though the Dodd-Frank Act specifically stated that limits should be established "with respect to physical commodities OTHER THAN EXCLUDED COMMODITIES"?

Response: The Commission addressed this matter when it promulgated a final rule that sets forth acceptable practices that DCMs and SEFs may adopt for complying with the core principles related to the establishment of position limits, or position accountability rules in lieu of position limits, in products other than the 28 enumerated physical commodity contracts. The final rule makes it an acceptable practice for an entity to adopt, enforce, and establish spot-month position limits and single-month and all-months-combined position limits. However, as an alternative to adopting such position limits, the regulation provides acceptable practices for adopting position accountability rules, with specific examples for a number of contracts on excluded (financial) commodities, such as contracts on a major foreign currency or a non-narrow securities index. Contracts on interest rates were not specifically addressed, as was the case in prior guidance.

Thus, with respect to excluded commodities, consistent with the current practice, DCMs and SEFs may adopt position accountability rules in lieu of position limits, as appropriate.

4) You have previously testified to Congress that the SEC and CFTC are coordinating on the rulemaking process. And while that may be true on joint rulemaking, I am concerned that the many divergent rules coming out of your respective agencies suggest that you are not coordinating sufficiently. As these rules will ultimately impact the end users of derivatives, coordination is critical to enacting a workable regulatory regime. Can we expect more harmonized final rules than those currently proposed?

Response: The CFTC and SEC have coordinated their rulemaking proposals, and are committed to harmonizing final rules to the greatest degree possible.

Can you explain the rationale for the agencies' different rules for real time reporting, where the agencies have incongruent rules for (a) the definition of what "real time" means, (b) block trade definition and reporting time for block trades, (c) the number of data fields that must be reported, (d) which entity is tasked with submitting trade information to the public?

Response: Throughout the rulemaking process, the CFTC staff consulted with the SEC staff to harmonize SEC and CFTC rules where appropriate. However, there are significant differences between the products that are under the jurisdiction of each Commission and the users of swaps in those markets. Those differences may require different regulatory treatment.

The CFTC definition of "real-time" is flexible, taking into account the nature of the reporting entity and the prevalence of technology by comparable reporting entities. For example, an end-user might not be expected to meet the same reporting time requirements that a SEF or DCM would be expected to meet.

The final real-time reporting rule did not address block trades. In light of comments it received, the Commission believed that it was prudent to re-propose rules for determining the appropriate minimum block trade size and to establish appropriate reporting delays for block trades. The Commission's reproposal was published in the Federal Register on March 15, 2012.

As for the number of data fields to be reported, the assets and instruments underlying commodity swaps are more diverse than those underlying equity-based swaps and single-name CDS, which are relatively more standardized. With respect to the entity responsible for making trade information public, the final CFTC rule is consistent with the SEC's proposal. Specifically SDRs will bear that responsibility.

The CFTC will continue to work closely with the SEC on rulemaking harmonization.

5) You have previously testified that you are in contact with regulators in Europe and beyond, and that you expect them to follow the American approach. But what assurances – real, concrete assurances – do you have that these jurisdictions will follow our approach? How can you convince us that we won't see American firms lose business to foreign competitors?

Have you entered into any memoranda of understanding with foreign regulators that assure that their approach will not materially differ from the new rules regime we apply? Are there any assurances that you can point to other than saying "trust me"?

Response: In implementing the Dodd-Frank Act, the Commission has sought to obtain the views of the entire spectrum of market participants and regulators. The Commission and its staff have worked extensively with fellow domestic and foreign regulators to ensure coordination and cooperation to the maximum degree practical. As we do with domestic regulators, we are sharing many of our memos, term sheets and draft work product with international regulators. We have been consulting directly and sharing documentation with the European Commission, the European Central Bank, the UK Financial Services Authority, the European Securities and Markets Authority, the Japanese Financial Services authority and regulators in Canada, France, Germany and Switzerland. The Commission's rulemaking process has benefitted greatly from the feedback of foreign authorities. Ongoing consultation has contributed in particular to efforts on rulemakings regarding designated clearing organization core principles, systemically important designated clearing organizations, registration requirements for foreign boards of trade, and data recordkeeping and reporting rules.

Regulators across the globe continue to work together towards achieving common goals including the G-20 agreement of September 2009 that: all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by the end of 2012 at the latest. OTC derivative contracts should be reported to trade repositories. And non-centrally cleared contracts should be subject to higher capital requirements.

The swaps market is global and interconnected, which makes it imperative that the United States consult and coordinate with foreign authorities. The Commission is actively communicating internationally to promote robust and consistent standards and avoid conflicting requirements, wherever possible. The Commission participates in numerous international working groups regarding swaps, including the International Organization of Securities Commissions Task Force on OTC Derivatives, which the CFTC co-chairs. The CFTC, SEC, European Commission and European Securities Market Authority are intensifying discussions through a technical working group. The Commission also has developed a bilateral dialogue on OTC derivatives with other jurisdictions including Hong Kong, Singapore, Japan, and Canada. Discussions have focused on the details of the rules, including mandatory clearing, trading, reporting and regulation of derivatives market intermediaries. This collaboration is intended to bring consistency to oversight of the swaps markets. I also anticipate the Commission will explicitly seek public input on the cross-border application of Title VII.

6) You have indicated that your agencies plan to propose a rule for public comment limiting the extraterritorial reach of the derivatives rules. This is an important topic that requires a rulemaking in order to ensure the public has the opportunity to comment and provide input.

Do you anticipate that such a rule or guidance will be issued by the end of this year, and if not, then when might we see it?

Given the significant impact of the derivatives rules, do you agree that your agencies need to provide an explicit rule in order to provide clarity and to define the jurisdictional reach of the CFTC and regulators overseas?

Do you agree that such guidance should be a coordinated CFTC-SEC effort?

7) In congressional testimony and other public statements Chairman Schapiro has stated that the SEC will propose a "holistic" rule on international/extraterritorial issues relating to the agency's implementation of Title VII. As I understand it, this means that the agency will consider the international implications of all of the new derivatives rules. In addition, the SEC has an existing regulatory structure for extraterritorial treatment of securities law known as Regulation S.

I believe you have commented that the CFTC does not plan to approach the extraterritorial issues in a "holistic" manner. Do you realistically believe these issues can be solved through individual MOUs, a process that would likely take years, or is there another way that you are considering?

Response to questions 6) and 7): I anticipate that the Commission will explicitly seek public input on the cross-border application of Title VII of the Dodd-Frank Act. The Commission will coordinate with the SEC regarding this effort.

Senator Charles Grassley

14.) I am concerned about a change the CFTC is proposing in the "conforming amendments" rule that has to do with additional recording and record keeping requirements that would directly impact rural businesses and farmers. I do not believe this part of the regulation was

called for under the Dodd-Frank Act, but it would extend the new requirements, intended for swaps, to grain buyers operating in the cash markets.

Under this proposed regulation, local grain elevators across Iowa would be bound by this regulation, and it would require elevators to record, among other things, all oral communications (telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device or other digital or electronic media) that lead to execution of cash transactions with farmers. And those records would have to be kept for a number of years. I have serious concerns with whether this regulation is necessary or cost-effective.

Has CFTC done a cost-benefit analysis on this specific provision taking into account its broad reach and impact on local grain elevators and farmers? If not, why not?

Does the CFTC intend to go forward with this provision in the final regulations even though it is not required, nor intended, under Dodd-Frank?

Response: One of the Commission's proposed amendments to its Rule 1.35 would require all futures commission merchants, retail foreign exchange dealers, introducing brokers, and members of designated contract markets or swap execution facilities to keep records of all oral and written communications that lead to the execution of a commodity interest or cash commodity transaction. The proposed rule specifically asked that the public provide comment regarding cost and benefits. In response to the proposal, the Commission has received numerous comments from the affected entities, including members of designated contract markets who may include farmers and local grain elevators, regarding the potential costs and benefits associated with the proposal. The Commission is reviewing these comments and has met with several of the commenters, as well as third party vendors, to ensure that the final rules do not impose undue costs on market participants.

Senator John Thune

1) Chairman Gensler, is there one person or "Task Force" at the CFTC who is looking at every proposed rule under Dodd-Frank, and considering how it will affect nonfinancial companies going about their everyday operations to protect American business from overreaching regulation? ?

Response: Two principles are guiding the Commission throughout its rulemaking process. First is the statute itself. We intend to comply fully with the statute's provisions and Congressional intent to lower risk and bring transparency to the swaps market. Second, we are consulting heavily in all areas with both other regulators and the broader public. Immediately after the Dodd-Frank Act was signed, rulemaking teams from Commission staff began soliciting views from the public – including nonfinancial companies – through written submissions, staff-led roundtables, and hundreds of meetings. Each proposed rule sought further public comment, including regarding the costs that might affect the everyday operations of American businesses. Each team also included representatives

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

2) Is the CFTC working closely with other regulators to avoid regulatory overlap, and to avoid imposing new and unnecessary recordkeeping and other administrative burdens on nonfinancial American businesses? Main Street didn't cause the financial crisis. These companies aren't interconnected with the global financial system. They don't "trade" financial products. They just hedge commercial risks. Why should they be burdened with excessive recordkeeping, reporting and documentation costs at all as they go about their business?

Response: The Commission takes great care to ensure that end-users are not burdened with excessive costs. For instance, when the Commission completed the real-time reporting rule to bring transparency to the swaps market, it was mindful of end-users, giving them more time to do their reporting. Consistent with congressional intent, the CFTC is working to finalize a rule ensuring that end-users using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing. The Commission's proposed rule on margin for swap dealers likewise provides that end-users will not have to post margin for uncleared swaps.

3) Chairman Gensler, we have heard over and over during the past year from nonfinancial companies that the Dodd-Frank Act rules proposed so far -- even the most basic rules defining "swap" -- are being drafted without sufficient clarity. An end-user should be confident, from a simple review of one or two rules, that everyday transactions are or are not "swaps."

How can a commercial business know how to comply with complicated new market rules, unless the rules and definitions are clear?

We can't expect an end user to read the full Commodity Exchange Act (CEA) and all the CFTC literature before it hedges an everyday commercial risk. Surely an end-user has a right to know whether it needs to comply with your rules, or might otherwise risk doing something "unlawful," when it enters into an everyday commercial contract?

They shouldn't need to call a broker, or a lawyer, to understand whether it's a "swap" or is "unlawful unless compliant with CEA rules."

Response: The joint CFTC-SEC proposed rule to further define the terms "swap," "security-based swap," "mixed swap" and "security-based swap agreement" was published in the Federal Register on May 23, 2011. The Commissions have benefitted greatly from

substantial public comment in regard to the rulemaking, including from many end-users. It is my hope that the Commissions will move forward shortly on the final joint rules, which will provide clarity for end-users and all market participants on these products.

4) The Administration's original draft of Title VII was entitled "Improvements to Regulation of Over-The-Counter Derivatives Markets," and many did not realize that the proposal went far beyond the previously unregulated over-the-counter market, and in fact also included modifications to the core principles that govern transparent, highly regulated futures exchanges – modifications I am told originated with the CFTC. Now the CFTC has taken these minor modifications to the exchange principles and proposed more prescriptive rules to govern these futures exchanges. Principled-based futures regulation has historically worked well. Why now would the CFTC seek to fix something that isn't broken with more prescriptive and potentially damaging rules for futures exchanges, particularly given claims of resource constraints and the apparent desire and charge to take on more responsibility in the swaps markets?

Response: In implementing the provisions of the Commodity Futures Modernization Act (CFMA), the Commission adopted a regulatory framework for part 38 of its regulations that consisted largely of general application guidance and acceptable practices consistent with the CFMA's principles-based regime. The Dodd-Frank Act generally provides that the Commission, in its discretion, may determine by rule or regulation the manner in which boards of trade comply with the core principles. Accordingly, the Commission undertook a comprehensive evaluation of its existing regulations, guidance and acceptable practices associated with each of the core principles. Based on that review, the Commission proposed both new and revised regulations and guidance and acceptable practices for some core principles, as described in the notice of proposed rulemaking.

The proposed new regulations largely codify procedures and practices that are commonly accepted in the industry and have been found, based on the Commission's administrative experience in overseeing the futures markets since passage of the CFMA, to represent the best practice means of complying with the core principles. Some of those requirements are based on recommendations that were included in Rule Enforcement Reviews ("RERs"), periodically carried out by Commission staff. The RERs are part of the Commission's oversight program, and serve as a key tool for monitoring a DCM's compliance with the core principles, and also as a primary means for identifying industry trends and DCM best practices for self-regulation.

As noted in the notice of proposed rulemaking, the Commission believes that the promulgation of clear-cut and definite requirements or practices in those instances where a standard industry practice has developed would provide greater certainty to the industry. Accordingly, in certain circumstances, the Commission proposed to replace the general application guidance and acceptable practices with regulations that codify the relevant practices and requirements for those core principles. For core principles added by the Dodd-Frank Act, the Commission also proposed regulations that represented the best practice. For several core principles, the Commission proposed to maintain the guidance

and acceptable practices, albeit with proposed revisions that reflect developments in the industry and the Commission's experience since the passage of the CFMA.

The Commission is currently reviewing the comments submitted in response to the notice of proposed rulemaking, including comments pertaining to the promulgation of rules, and will take all comments into consideration in finalizing the rule.

6) Marketing agricultural commodities through hedging and use of futures has become nearly as important as growing the crop – what has occurred with MF Global has severely damaged these practices for many producers and facilities. In plain and simple terms what is your plan not only of action items but outreach to the agriculture community that use of hedging and futures markets can be safely continued?

Response: Farmers, ranchers, producers, processors and packers all rely on futures and swaps markets to lock in the price of a commodity and manage risk. The futures and swaps markets help them to focus on what they do best – producing food and fiber and other products for the nation.

While in the early days the markets were dominated by producers and processors, over time, the makeup of these markets has shifted dramatically. Financial firms and speculators now make up the vast majority of these markets. The end-users represent a small part of the overall markets, and it is critical that the CFTC protect the farmers, producers and merchants.

The Commission has benefitted greatly from substantial input of the agricultural community throughout the rulemaking process, , including through its Agricultural Advisory Committee. The CFTC staff and Commissioners will continue reaching out to the agricultural community for its very important feedback as we finalize rules.

Senate Committee on Agriculture, Nutrition & Forestry
Continuing Oversight of the Wall Street Reform and Consumer Protection Act
December 1, 2011
Questions for the Record
Chairwoman Mary Schapiro

Questions from Chairwoman Debbie Stabenow:

1) A goal of Dodd-Frank was to mitigate systemic risk and as a part of that, it promoted central clearing. I understand that the SEC is currently considering an exemption that would allow the CFTC to oversee accounts that comingle single-name CDS (overseen by the SEC) with index CDS (overseen by the CFTC), and put them into a single omnibus account overseen by the CFTC. Do you or your staff have any concerns with this request of which I should be aware? If not, I encourage you to move expeditiously on approving the request.

The SEC approved a request by ICE Clear Credit for portfolio margining of clearing members' *proprietary* single-name CDS and index CDS positions on December 16, 2011. While ICE Clear Credit currently does not offer clearing of single-name CDS for *customer-related* transactions, it filed parallel petitions with the SEC and CFTC requesting permission to: (1) hold customer assets used to margin, secure or guarantee customer positions consisting of cleared CDS that are both single-name CDS and index CDS positions in a commingled customer omnibus account; and (2) calculate margin for this commingled customer account on a portfolio margin basis. The SEC petition is posted for comment on the SEC website.[1] The Commission staff has had discussions with representatives of clearing agencies (including ICE Clear Credit), clearing agency members, and customers of clearing agency members that would be affected by the relief requested.

The Commission staff is currently evaluating ICE Clear Credit's petition, including issues with respect to risk management, the protection of customer assets, and competition. Such issues arise in part as a result of the separate statutes and bankruptcy regimes that apply to swaps and security-based swaps. The Commission staff is actively working with CFTC staff to determine how best to address these issues so that any recommendations the staffs might make to the Commission and the CFTC would include appropriate protections for customer assets in the event of a member insolvency and so that there is a reduced risk that competition based on portfolio margin levels would contribute to systemic risk.

2) Prior to the financial crisis, the Securities and Exchange Commission made significant progress in adopting a rule that would have created a limited federal exemption for business brokers who act in limited roles as both intermediaries and advisors during the purchase and sale of existing small businesses. In 2006, the Commission issued a no-action letter granting enforcement relief to a small business broker who acted in a limited role during a business sale. Small business development, which includes the purchase and sale of existing businesses, is paramount to developing

[1] See http://www.sec.gov/rules/petitions/2011/petn4-641.pdf.

a strong economic base. Has the SEC considered taking additional steps to codify this limited small business broker exemption?

The staff of the Division of Trading and Markets, which is primarily responsible for administering the regulation of brokers and dealers, is analyzing the SEC's rules and regulations that apply to business brokers. The Division staff is developing options that it could recommend that the Commission consider to revise those regulations in light of the role that business brokers play in the purchase, sale, exchange or transfer of the ownership of privately owned businesses. The Division staff is also revisiting existing guidance about whether certain business brokers must be registered with the SEC as brokers in order to determine whether the Commission or the staff should provide further guidance in this area. We are mindful of the importance of considering both the burdens on small businesses' capital formation arising from our regulatory requirements and the benefits of those requirements to investors and other market participants.

Questions from Ranking Member Pat Roberts:

1) Are you or are you not going to have a uniform Swaps Execution Facility (SEF) rule with the CFTC?

SEC staff continues to work closely with CFTC staff as each agency reviews comments and develops recommendations with respect to its proposals relating to SEFs, but it is unlikely that the agencies will adopt an identical rule. Overall, the SEC and CFTC proposals relating to SEFs are more similar than they are different. For example, both proposals for swap execution facilities have similar registration programs, as well as similar filing processes for rule changes and new products. However, there are differences between the products, markets, and market participants that could impact – and could be impacted by – the rules of the SEC and the CFTC. The SEC staff is reviewing input from the public as to whether the differences in the SEC's and CFTC's proposals are supported by distinctions in the trading and liquidity characteristics of swaps and security-based swaps, or whether the agencies' rules may be further harmonized – and if so, how.

2) You have testified here again today that you are coordinating on the rulemaking process. Is this just for joint rulemaking? Which rules are going to be jointly considered?

As you know, Title VII of the Dodd-Frank Act requires that the SEC and the CFTC, in consultation with the Board of Governors of the Federal Reserve System, work jointly to further define certain key terms – including, for example, "swap dealer", "security-based swap dealer", "swap", and "security-based swap". The SEC and the CFTC are also required to jointly establish regulations regarding "mixed swaps" and the way in which books and records must be kept for security-based swap agreements. The definitional rules were jointly proposed by the Commission and the CFTC in December 2010 and April 2011, and Commission staff is actively working with CFTC staff to develop joint final rules for the Commission and the CFTC to consider.

In addition to these joint rules, the Dodd-Frank Act calls for the SEC and the CFTC to consult and coordinate on other rulemaking under Title VII for the purposes of assuring regulatory

consistency and comparability to the extent possible. The SEC staff has done so extensively in the development of the SEC's proposed rules, with the objective of establishing consistent and comparable requirements, where possible, given the differences in the swap and security-based swap markets. For example, the SEC staff has participated in numerous joint meetings and has shared term sheets and drafts of SEC proposed rulemakings with CFTC staff. Each of the SEC rulemaking teams also has engaged in a more informal dialogue and exchange of ideas with their counterparts at the CFTC. We will continue these efforts as we move toward the adoption of final rules.

If indeed you are collaborating, then please describe the rationale for the agencies' divergent rules on:

- *Swap Execution Facility (SEF) rules: The CFTC is requiring quotes from at least 5 liquidity providers, while the SEC takes a more reasonable approach in allowing the customer to choose the number of quotes; and*

The SEC's proposal would require that a security-based SEF that provides a request for quote functionality permit a participant to send a request for quote to all other liquidity-providing participants of the facility, and would allow the security-based SEF to provide that a participant could choose to send a request for quote to less than all other participants, including to as few as one participant.

The SEC proposed to interpret the definition of "security-based swap execution facility" to mean a system or platform that allows more than one participant to interact with the trading interest of more than one other participant on that system or platform. The SEC noted that a system or platform that affords a quote requesting participant the ability to send a request for quote to all participants, but also permits the quote requesting participant to choose to send a request for quote to fewer participants, would satisfy the statutory definition because multiple participants would have the ability to execute or trade security-based swaps by accepting bids or offers made by multiple participants. Rather than proposing a rule that would establish a prescribed configuration for security-based SEFs, the Commission proposed to provide baseline principles which any entity would need to be able to meet to register as a security-based SEF, an approach designed to allow flexibility to those trading venues that seek to register with the Commission as a security-based SEF and that would permit the continued development of organized markets for the trading of security-based swaps.

The comments on the proposed interpretation generally have been favorable. The SEC staff will continue to evaluate the comments to determine whether differences between the SEC and CFTC proposals are warranted by differences in the relevant products, markets or market participants.

- *Real time reporting requirements where each agency is proposing different definitions of what "real time" means, definitions and reporting requirements for block trades, the number of data fields that must be reported and which entity is tasked with submitting trade information to the public.*

Differences in "real time" definition. In the SEC's proposed rules on real-time reporting and dissemination ("Regulation SBSR"), the SEC proposed to define "real time" to mean "as soon as technologically practicable, but in no event later than 15 minutes after the time of execution." In proposing an explicit outer bound for real-time reporting, the SEC stated that it "believes it is appropriate to encourage market participants to take steps to minimize manual handling of [orally negotiated security-based swap] transactions, because the Dodd-Frank Act requires price and volume information for all security-based swap transactions to be disseminated as soon as technologically practicable after the time of execution."

In the CFTC's final rules on real-time reporting and dissemination, "real time public reporting" is defined to mean "the reporting of data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed." The final rules defined "as soon as technologically practicable" to mean "as soon as possible, taking into consideration the prevalence, implementation and use of technology by comparable market participants."

It is the SEC staff's understanding that CFTC-regulated swap markets may include a significant number of trades between market participants that likely would not fall within the swap dealer or major swap participant categories. By contrast, it is SEC staff's understanding that the majority of trades in security-based swaps under the SEC's jurisdiction have at least one counterparty that likely would fall within the security-based swap dealer category, and therefore may have the infrastructure to report security-based swap transactions more promptly. SEC staff continues to review comments received on the SEC's proposed definition of "real time", including in the context of the CFTC's final rules, the operations of the security-based swap markets vs. the swap markets, and the technological capabilities of reporting parties.

Definitions and reporting requirements for block trades. The SEC did not include in proposed Regulation SBSR a formal proposal for how to define block thresholds. Rather, the SEC stated that it would issue a formal proposed rulemaking regarding block thresholds in the future. Although the CFTC did propose block thresholds, it did not adopt any such thresholds in its final real-time reporting and dissemination rules. The CFTC instead indicated its intention to conduct additional rulemaking to determine such block thresholds. Thus, both agencies plan to engage in future proposed rulemaking so as to best benefit from public comment on this subject.

The number of data fields that must be reported. The SEC did not propose to require reporting of specific data elements for SBS transactions. Instead, the SEC proposed to require broad categories of information, such as "the terms of any fixed or floating rate payments" and "the data elements necessary for a person to determine the market value of the transaction," to be reported. These are not discrete "data fields," and fully capturing such information could require a number of different data fields. Instead, the SEC proposed to require SDRs to develop policies and procedures for the specific reporting protocols. This proposed approach was designed to leverage the experience of SDRs and their participants to suggest the most efficient ways to report information on complex derivatives, and to provide greater flexibility with respect to reporting requirements over time.

The CFTC took a different approach by proposing, and ultimately adopting, specific data elements that would be required to be reported. The SEC staff preliminarily believes that the scope and type of information that would be required to be reported under either approach would be substantially similar. However, the SEC staff continues to analyze comments received on the SEC's proposed approach, including comments on any differences between our proposal and the CFTC's final rules.

Which entity is tasked with submitting trade information to the public. The SEC proposed that SDRs would be the entities required to disseminate security-based swaps data to the public. Likewise, the final rules adopted by the CFTC provide that SDRs will be the entities required to disseminate swap transaction data to the public.

> *3) Can you assure this committee that important congressionally-mandated joint rules, such as product and entity definitions, will in fact be issued jointly?*

Yes. The Dodd-Frank Act requires that the rules further defining the key entity and product definitions arising under Title VII be established jointly by the SEC and the CFTC. These two sets of rules were jointly proposed by the SEC and the CFTC in December 2010 and April 2011, respectively, and the SEC and CFTC are actively proceeding forward toward the adoption of final rules.

> *4) What is your opinion of the Crapo Amendment offered during the Senate Agricultural Appropriations debate?*
>
> *One of the points made by Senator Crapo's Amendment is that it would seem logical to define certain key terms prior to finalizing other rules or heading overseas to impose our will on others. For instance, what is a swap contract, who is a swap dealer and who will be defined as major swap participants? Are you in a position to be able to enlighten us on when these seemingly fundamental questions will be answered?*

As noted above, the SEC and the CFTC jointly proposed rules further defining the key entity definitions and product definitions in December 2010 and April 2011, respectively. We understand how fundamental these definitional rules are to the application of Title VII and we are actively working toward adoption of the relevant joint final rules so that they will be in place before requiring compliance with the substantive requirements of the security-based swap regulatory regime.

> *5) We seem to be having difficulty right now with some of our most basic core competencies of market regulation yet you're intending to oversee the complex OTC market, not just in the United States, but overseas? What assurances do you have that overseas jurisdictions will follow our approach? How can you convince us that we won't see American firms lose business to foreign competitors over these regulations once they are in place? Has anyone analyzed the cost of applying Title VII overseas?*

The Commission has been – and continues to be – strongly supportive of coordinating regulatory reforms to meet the G-20 Leaders' commitments to central clearing, trading and reporting of

OTC derivatives by the end of 2012, as well as the objectives underlying these commitments, which include improving transparency in the derivatives markets, mitigating systemic risk, and protecting against market abuse. The Commission staff has been actively engaged in ongoing discussions with foreign regulators regarding the direction of international derivatives regulation generally, and the Commission's efforts to implement Title VII. For example, since July 2011, we have engaged in a series of regulatory dialogues with representatives of the European Union, Japan, Hong Kong, Singapore and Canada about our respective regulatory reform efforts. These discussions have been focused on working towards substantive coordination of emerging regulatory regimes.

The Dodd-Frank Act has placed the United States at the forefront of derivatives regulatory reform and on a faster timeline relative to the other jurisdictions with major derivatives markets. While this status provides us with an opportunity to shape the global derivatives regulatory landscape, we also face challenges in coordinating with other regulators, as they are earlier in the process of establishing their legislative and regulatory frameworks. As the Commission continues the Title VII rulemaking process, we are mindful of the potential for regulatory arbitrage, which could impact the competitiveness of the U.S. derivatives markets and U.S. entities in the global derivatives markets, as well as undermine the goals of Title VII. In addition, we are mindful of the potential costs of various regulatory approaches.

We have been carefully considering such issues as we develop proposed and final rules, including rules that would clarify the application of Title VII to cross-border security-based swap transactions and the persons that engage in such transactions. We have solicited and welcome comments on our proposed rulemakings regarding the potential impact they may have on the derivatives markets, especially comments that offer suggestions for mitigating regulatory arbitrage opportunities while achieving the goals of Title VII. We will take these comments into account as we move toward adoption of final rules.

- *Have your agencies entered into any memoranda of understanding with foreign regulators that assure that their approach will not materially differ from the new rules regime we apply? Are there any assurances that you can point to other than to say "trust me?"*

As you know, there are a range of views internationally on the appropriate way to carry out derivatives regulatory reform. The Commission has been actively engaged in ongoing discussions with foreign regulators regarding the direction of international derivatives regulation generally and the Commission's efforts to implement Title VII's requirements. For example, the SEC, along with the CFTC, the United Kingdom's Financial Services Authority, and the Securities and Exchange Board of India, co-chairs the Task Force on OTC Derivatives Regulation of the International Organization of Securities Commissions (IOSCO). One of the primary goals of the IOSCO Task Force is the development of consistent international standards related to OTC derivatives regulation. In addition, on behalf of IOSCO, the SEC, along with the European Commission and the Federal Reserve Bank of New York, co-chairs the Financial Stability Board's OTC Derivatives Working Group, which is comprised of a number of authorities responsible for OTC derivatives in their jurisdictions. Furthermore, since July 2011, we have engaged in a series of regulatory dialogues on derivatives reform with the European

Union, Japan, Hong Kong, Singapore, and Canada to discuss substantive coordination of emerging regulatory regimes, and the SEC continues to participate in the US-EU Financial Markets Regulatory Dialogue organized in conjunction with the US Treasury Department.

However, given that most foreign jurisdictions that are undertaking derivatives reforms have not yet finalized their legislation and implementing regulations and, in some instances, have not yet begun to adopt such legislation, a number of potential conflicts are not yet ripe to be addressed. Nonetheless, through Commission staff's active engagement with foreign regulators concerning the direction of global derivatives regulation, we are working to develop consistent international standards in this area and to identify and resolve any potential conflicts with foreign law, where possible.

Questions from Senator Saxby Chambliss:

> *1) While I can see that there might be some justification for differences in rules from the CFTC and SEC related to different products, there is no justification for how US law should be applied abroad.*
>
> *Why are the CFTC and SEC not writing a joint rule on the extraterritorial application of Title VII?*

Since the Dodd-Frank Act's passage, SEC staff has been engaged in discussions with CFTC staff regarding our respective approaches to implementing the statutory provisions of Title VII in areas where Congress did not require joint rulemaking, such as the cross-border application of Title VII. With regard to the cross-border application of Title VII, we will continue to coordinate with the CFTC as we work to develop proposed rules concerning the treatment of cross-border security-based swap transactions and the persons that engage in such transactions.

> *2) I understand there is a pending request before the Commission asking for an exemption to permit the co-mingling of security-based swaps (single-name CDS) with index CDS in an account overseen by the CFTC. This type of request promotes capital efficiency and, as I understand it, has broad industry support. Most importantly it promotes clearing as called for under Dodd Frank. Can you tell us if your staff has made any progress on this request or identified any policy issues that stand as an impediment to the granting of this request which I understand is critical to ensuring the buy-side utilizes central clearing for these products?*

The SEC approved a request by ICE Clear Credit for portfolio margining of clearing members' *proprietary* single-name CDS and index CDS positions on December 16, 2011. While ICE Clear Credit currently does not offer clearing of single-name CDS for *customer-related* transactions, it filed parallel petitions with the SEC and CFTC requesting permission to: (1) hold customer assets used to margin, secure or guarantee customer positions consisting of cleared CDS that are both single-name CDS and index CDS positions in a commingled customer omnibus account; and (2) calculate margin for this commingled customer account on a portfolio margin basis. The

SEC petition is posted for comment on the SEC website.[2] The Commission staff has had discussions with representatives of clearing agencies (including ICE Clear Credit), clearing agency members, and customers of clearing agency members that would be affected by the relief requested.

The Commission staff is currently evaluating ICE Clear Credit's petition, including issues with respect to risk management, the protection of customer assets, and competition. Such issues arise in part as a result of the separate statutes and bankruptcy regimes that apply to swaps and security-based swaps. The Commission staff is actively working with CFTC staff to determine how best to address these issues so that there are appropriate protections for customer assets in the event of a member insolvency and so that there is a reduced risk that competition based on portfolio margin levels would contribute to systemic risk.

3) You have previously testified to Congress that the SEC and CFTC are coordinating on the rulemaking process. And while that may be true on joint rulemaking, I am concerned that the many divergent rules coming out of your respective agencies suggest that you are not coordinating sufficiently. As these rules will ultimately impact the end users of derivatives, coordination is critical to enacting a workable regulatory regime. Can we expect more harmonized final rules than those currently proposed?

As you know, the Dodd-Frank Act calls on the SEC and the CFTC to consult and coordinate for the purposes of assuring regulatory consistency and comparability to the extent possible. The Dodd-Frank Act also calls on the agencies to treat functionally or economically similar products or entities in a similar manner, but does not require identical rules.

The SEC staff has consulted and coordinated with the CFTC staff in the development of our proposed rules and will continue to do so as we move into the rule adoption phase. Our objective has been to establish consistent and comparable requirements. However, as you note, there are differences in some of our proposed rules. In certain areas, we believe it may be appropriate for the Dodd-Frank Act's application to security-based swaps to be different from its application to the swaps that will be regulated by the CFTC, as the relevant products, entities, and markets themselves are different, or because the relevant statutory provisions are different. Accordingly, differing approaches to the regulation of swaps and security-based swaps may be warranted in some instances.

Throughout the rulemaking process, we have been particularly mindful of the potential burdens on entities that will be dually registered with the SEC and the CFTC. To this end, we have specifically requested comment in several rule proposals on the impact of the overall regulatory regime for such registrants. We are carefully considering this input in crafting our final rules.

- *Can you explain the rationale for the agencies' different rules for real time reporting, where the agencies have incongruent rules for (a) the definition of what "real time" means, (b) block trade definition and reporting time for block*

[2] See http://www.sec.gov/rules/petitions/2011/petn4-641.pdf.

trades, (c) the number of data fields that must be reported, (d) which entity is tasked with submitting trade information to the public?

Differences in "real time" definition. In the SEC's proposed rules on real-time reporting and dissemination ("Regulation SBSR"), the SEC proposed to define "real time" to mean "as soon as technologically practicable, but in no event later than 15 minutes after the time of execution." In proposing an explicit outer bound for real-time reporting, the SEC stated that it "believes it is appropriate to encourage market participants to take steps to minimize manual handling of [orally negotiated security-based swap] transactions, because the Dodd-Frank Act requires price and volume information of all security-based swap transactions to be disseminated as soon as technologically practicable after the time of execution."

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report information on complex derivatives, and to provide greater flexibility with respect to reporting requirements over time.

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> *4) You have indicated that your agencies plan to propose a rule for public comment limiting the extraterritorial reach of the derivatives rules. This is an important topic that requires a rulemaking in order to ensure the public has the opportunity to comment and provide input.*
>
> - *Do you anticipate that such a rule or guidance will be issued by the end of this year, and if not, then when might we see it?*

The Commission anticipates proposing rules in the first half of 2012 pertaining to the application of Title VII of the Dodd-Frank Act to cross-border security-based swap transactions and to foreign persons engaged in security-based swap transactions with U.S. counterparties.

> - *Given the significant impact of the derivatives rules, do you agree that your agencies need to provide an explicit rule in order to provide clarity and to define the jurisdictional reach of the CFTC and regulators overseas?*

Given the global nature of the derivatives markets, we believe it is crucial to consider how various provisions of Title VII apply to cross-border security-based swap transactions and non-U.S. persons acting in capacities regulated under Title VII. In doing so, our primary concern is protecting U.S. derivatives market participants and financial markets in accordance with the Commission's congressional mandate. We also are mindful of the potential to put U.S. businesses at a competitive disadvantage to their foreign counterparts. In fact, we are required under the Securities Exchange Act of 1934 to consider the effect upon competition of our rulemakings.

Because of these important issues, we intend to address the international implications of Title VII of the Dodd-Frank Act in a single proposal that would address the relevant international issues in a holistic manner. This approach would give investors, security-based swap market participants, foreign regulators, and other interested parties an opportunity to consider our proposed approach to the regulation of cross-border security-based swap transactions and the persons that engage in such transactions.

- *Do you agree that such guidance should be a coordinated CFTC-SEC effort?*

As noted above, SEC staff continues to consult with CFTC staff as they work to develop propose rules concerning the treatment of cross-border security-based swap transactions and the persons that engage in such transactions.

5) In congressional testimony and other public statements Chairman Schapiro has stated that the SEC will propose a "holistic" rule on international/extraterritorial issues relating to the agency's implementation of Title VII. As I understand it, this means that the agency will consider the international implications of all of the new derivatives rules. In addition, the SEC has an existing regulatory structure for extraterritorial treatment of securities law known as Regulation S.

Is the SEC considering using the securities law framework in the context of derivatives regulation as you consider the extraterritorial reach of Title VII? And if not, could you explain why you are not considering that framework?

The Commission's existing framework for the treatment of cross-border securities transactions was developed over many years as the securities market became more globalized. Within the context of Title VII, the Commission staff is considering the cross-border application of the regulatory requirements arising under the Dodd-Frank Act and how to apply those requirements to a global derivatives market that already exists. In doing so, we are taking into account our traditional approach to the treatment of cross-border securities transactions, but we are also considering the characteristics of the derivatives markets and our statutory authority under the Dodd-Frank Act.

We expect that our overall approach to cross-border issues under Title VII will generate thoughtful and constructive comments to inform the Commission in developing final rules regarding the application of Title VII to cross-border security-based swap transactions.

Questions from Senator John Thune:

Economic Analysis:

1) I'm concerned that agencies are not conducting rigorous quantitative analyses of the costs and benefits of their rules and the effects those rules could have on the economy and our competitive position in a global marketplace.

How do you intend to ensure that the rules that your agency adopts under Dodd-Frank are supported by rigorous economic analysis?

The Commission considers a variety of economic factors in promulgating rules, and it takes these considerations seriously. The primary purpose for performing economic impact analysis is to assist the Commission in making sound regulatory choices about the difficult discretionary decisions with which it is faced. By including such analyses in its rulemaking releases, the

Commission informs the public, the courts, and Congress about the economic consequences of the choices it makes.

When proposing a rule, the Commission invites the public to comment on its analysis and provide any information and data that may better inform its decision making. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach promotes a regulatory framework that strikes an appropriate balance between the costs and the benefits of regulation.

In some cases, economic impact analysis is specifically required by statute. For example, the securities laws require the Commission, when it engages in rulemaking and is required to consider or determine whether the rulemaking is in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[3] Section 23(a) of the Exchange Act also requires the Commission, in making rules and regulations pursuant to the Exchange Act, to consider among other matters the impact any such rule or regulation would have on competition. The agency may not adopt a rule under the Exchange Act that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In addition, the Commission considers the economic impact of its rules pursuant to requirements under the Regulatory Flexibility Act, the Paperwork Reduction Act, and the Small Business Regulatory Enforcement Fairness Act of 1996.

The Commission also considers the costs and benefits of rules as a regular part of the rulemaking process. Certain costs or benefits may be difficult to quantify or value with precision, particularly those that are indirect or intangible.[4] But, we are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public impact both financial markets and industry participants who must comply with our rules. This is especially relevant given the scope, significance, and complexity of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Our Division of Risk, Strategy, and Financial Innovation ("RSFI") directly assists in the rulemaking process by helping to develop the conceptual framing for and assisting in the subsequent writing of the economic analysis sections of the Commission's rulemaking releases.

In light of recent court decisions, RSFI and the rule writing divisions are examining improvements in the economic analysis the SEC employs in rulemaking. Although the existing procedures and policies are designed to provide a rigorous and transparent economic analysis, we are taking steps to improve this process so that future rules are consistent with best practices in economic analysis.

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[3] See Securities Act § 2(b); Exchange Act § 3(f); Investment Company Act § 2(c); and Advisers Act § 202(c).

[4] In its report discussing cost-benefit analyses of Dodd-Frank Act rulemaking by financial regulators, the GAO noted that "the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure." GAO-12-151, p. 19; see also GAO-08-32.

International Harmonization:

2) As we focus today on the implementation of the derivatives title of the Dodd-Frank Act, European policymakers are crafting their own derivatives rules, the European Market Infrastructure Regulation, or "EMIR" proposal. By some accounts, this proposal seems to be roughly similar to the Dodd-Frank Act in certain respects, such as promoting clearing of derivatives. But I am concerned, like many others I think, about the notion that these European rules could have an extraterritorial application on U.S. firms. It seems to me as though there is a lack of progress on international harmonization.

What is backup plan if there is not international harmonization and are is your agency open to not finalizing these rules if the timing or content do not align overseas?

As you note, the most recent draft of the EMIR proposal would require eligible derivatives contracts to be cleared through central counterparties and would require all derivatives contracts (cleared and uncleared) to be reported to trade repositories, above a threshold to be determined by the European Securities and Markets Authority. The finalization of EMIR is anticipated in the near term, although even with relatively quick finalization, the European Union likely will be many months behind the United States with regard to its central clearing and trade reporting mandates.

As you know, the Dodd-Frank Act requires the SEC and the CFTC to adopt final rules implementing reforms of the derivatives market and imposes a much faster timeline relative to the other jurisdictions with major derivatives markets, including the European Union. The Dodd-Frank Act also requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of derivatives in order to promote consistent global regulation.

The Commission and its staff have been actively engaged with securities and market regulators in Europe and elsewhere, both through informal conversations and more formally through participation in various regulatory working groups, to discuss issues regarding the regulation of derivatives and to encourage foreign regulators to adopt similar regulations. Our coordination efforts to date have informed our thinking as we implement Title VII's requirements, and we will continue to engage in these efforts as we move forward to the adopting stage of our rulemaking.

3) Since the CFTC and SEC were responsible for overseeing different parts of MF Global's financial activities, media reports indicate that the CFTC and SEC did not adequately share information in the days leading up to the bankruptcy of MF Global. To what extent did the CFTC and SEC share information on the financial condition and record keeping practices of MF Global prior to its collapse on October 31st?

In late August 2011, SEC staff in the Division of Trading and Markets spoke with senior staff at the CFTC to inform them of discussions among the SEC staff, the Financial Industry Regulatory Authority ("FINRA"), the Chicago Board Options Exchange ("CBOE"), and MF Global

concerning the appropriate capital treatment of MF Global's repo-to-maturity positions on European sovereign debt (the "RTM positions"). Those discussions focused on whether, under the SEC's net capital rule, MF Global should be required to hold more regulatory capital due to the outstanding RTM positions. The ultimate conclusion of the SEC staff, FINRA, and CBOE was that MF Global must do so. Accordingly, following these discussions, on August 25, 2011, MF Global submitted to the SEC a notice that it had fallen below certain net capital early warning thresholds, a notice required by Rule 17a-11 under the Securities Exchange Act. Rule 17a-11 also required MF Global to provide a copy of this notice to its designated examining authority (in this case, the Chicago Board Options Exchange) and to the CFTC.

Additionally, on August 31, 2011, MF Global filed an amended July 31, 2011, FOCUS report (a required monthly report of financial and operational data) to reflect the amended net capital treatment for the RTM positions. The CFTC used the data reflected in MF Global's amended FOCUS report when it published its "Selected FCM Financial Data", with data received by August 31, 2011.[5]

During the week of October 24, 2011, the firm reported a substantial quarterly net loss and its credit rating was downgraded. Starting at the middle of this week, staff of the relevant federal regulatory authorities, including the SEC and the CFTC, communicated on an ongoing basis about the firm's ability to finance its business, efforts to identify potential strategic transactions, and other matters relevant to the firm's financial condition. This communication continued up to and after the Securities Investor Protection Corporation instituted proceedings on October 31, 2011.

> *4) Marketing agricultural commodities through hedging and use of futures has become nearly as important as growing the crop – what has occurred with MF Global has severely damaged these practices for many producers and facilities. In plain and simple terms what is your plan not only of action items but outreach to the agriculture community that use of hedging and futures markets can be safely continued?*

We will of course continue to defer to the CFTC as the responsible federal regulatory agency in terms of actions appropriate to protect regulated agricultural commodities and other futures markets used for hedging by the agriculture community. Separately, the SEC staff is considering whether to recommend changes to the rules within our authority – such as those governing securities customer assets – so as to further strengthen the existing customer protection regime. In considering such changes, we will continue to consult with the CFTC and other relevant regulatory authorities.

[5] See http://www.cftc.gov/ucm/groups/public/@financialdataforfcms/documents/file/fcmdata0711.pdf.

Senate Committee on Agriculture, Nutrition & Forestry
Continuing Oversight of the Wall Street Reform and Consumer Protection Act
December 1, 2011
Questions for the Record
Commodity Futures Trading Commission Staff responses regarding MF Global

Chairwoman Debbie Stabenow

2) We've heard from MF Global customers and the SIPA trustee for the liquidation of MF Global, Inc. that the claims forms used in the MF Global bankruptcy are complicated and burdensome. We have also heard that some of the complicated language in the forms is required by the agencies. Is there a way to simplify these forms so they are more customer-friendly?

Response: Some of the complications of the forms stem from the necessity to identify "customers" who are in fact non-public customers – that is, affiliates or insiders of the debtor FCM. Other complications stem from the need to identify "specifically identifiable property," and to protect customers' interests in that property. The Trustee has agreed to work with customers who have submitted claim forms but who have had difficulty in filling them out precisely.

Commission staff are reviewing the agency's bankruptcy regulations to determine if there are ways to simplify them while meeting the regulatory goal of protecting customers.

5) While we are still trying to understand the MF Global situation fully, there are apparently deficiencies in the systems that protect customer funds. Would the Commission need any new legislative authorities in order to handle problems implicated by the MF Global situation?

Response: Staff is continuing to consider this matter. Commission staff hosted a two-day roundtable on February 29 and March 1, 2012 focusing on enhancing customer protection. The roundtable provided staff with the opportunity to solicit the views of a broad spectrum of futures market participants, including agricultural interest, academics, pension funds and other money managers, derivative clearing organizations, futures commission merchants, introducing brokers, and other industry representatives. Staff currently is reviewing the information obtained during the roundtable and through a solicitation of public comment, and expects to make recommendations to the Commission on possible rule amendments to further the objective of protecting customer funds.

Ranking Member Pat Roberts

1) Regarding the CFTC's proposed rules on segregation of collateral for cleared swaps: in light of the events surrounding MF Global, is the CFTC considering re-proposing those rules?

Response: **On January 11, 2012, the Commission approved final rules on segregation of customer funds for cleared swaps. Under the final rule, futures commission merchants and derivatives clearing organizations must segregate customer collateral supporting cleared swaps, and the customer money must be protected individually all the way to the clearinghouse. Subsequently, Commission staff held two days of roundtables regarding customer protection issues and received specific input regarding extending a similar regime to customer collateral for futures contracts. Staff is expected to make recommendations to the Commission based on public comment received.**

Senator Charles Grassley

1) Starting in May 2010, in his first conference call with analysts, former MF Global CEO Jon Corzine said that MF Global would begin "taking principal risk across most of its product lines." This translates into Mr. Corzine stating that MF Global would start taking more risk with its own capital. Given this plain statement that MF Global would begin to pursue a more risky business model, did the CFTC pursue any heightened oversight of MF Global? If not, why not?

Response: At the time of Mr. Corzine's May 2010 conference call, MF Global already was subject to **heightened surveillance. In May of 2010, MF Global was registered with the Commission as a futures commission merchant ("FCM"). FCMs are required to maintain compliance with minimum capital requirements and customer funds protection requirements. Generally, FCMs file monthly unaudited financial statements with the Commission and with the firm's designated self-regulatory organization ("DSRO") demonstrating compliance with the minimum capital requirement and customer funds protection provisions of the Commodity Exchange Act and Commission regulations. MF Global, however, was placed on heightened surveillance by its DSRO, the CME, in March 2008 and was required to file with the CME daily unaudited capital computations and daily computations demonstrating compliance with the provisions regarding the holding of customer funds. The Commission also received copies of the daily capital computations and the computations regarding the holding of customer funds that MF Global filed with the CME. Commission staff reviewed the calculations each day to assess the firm's compliance with minimum capital and segregated funds requirements.**

2.) After previously rejecting MF Global's application to become a "primary dealer" for the Federal Reserve, the Federal Reserve Bank of New York approved MF Global's application to be a primary dealer in February 2011. As MF Global's primary regulator, what interaction did the CFTC have with the Federal Reserve regarding this decision?

<u>Response</u>: In April 2009, staff from the Federal Reserve Bank of New York contacted the CFTC's Division of Clearing and Intermediary Oversight ("DCIO") and Division of Enforcement ("DOE") concerning their evaluation of MF Global as an "aspiring primary dealer." Prior to the discussion, N.Y. Fed staff indicated that they would like to discuss the financial condition of the applicant (including capital, liquidity, and funding resources), adequacy of internal control environment, quality of management, and evaluation of recent enforcement actions and litigations. Due to information constraints at the NY Fed, in particular the fact that it is not a federal regulator, Division staff spoke to the NY Fed regarding publicly known information available at that time. During the discussion, Division staff informed the N.Y. Fed that they would not express an opinion regarding whether MF Global's primary dealer application should be accepted. Several weeks after the discussion, the NY Fed advised that MF Global's application to be a primary dealer was being deferred pending a quiet period following the resolution of the regulatory investigations and private litigation. In June 2010, the NY Fed again approached DCIO and DOE regarding the pending MF Global application. Subsequently, in February 2011 the NY Fed advised that it had determined to accept MF Global's application to be a primary dealer.

3.) Did the CFTC approve any leverage increases for MF Global. If so, what leverage level was approved and when was it approved?

<u>Response</u>: The CFTC did not approve any leverage increases for MF Global. Commission regulations impose a minimum capital requirement on FCMs. The capital requirement is based upon a percentage of the margin associated with customer and non-customer (e.g., affiliates) futures and options on futures positions carried by the FCM. CFTC regulations further provide that an FCM computes how much regulatory capital is actually has by subtracting all of the firm's liabilities (except certain subordinated loans) from the firm's current liquid assets. MF Global did not receive any relief from these requirements which are generally applicable to all FCMs.

4.) In MF Global's 10K for the year ending March 31, 2011, MF Global filed documents which indicated that they had heavy leverage exposure to European Sovereign debt. This exposure led to heightened default and liquidity risk. At this point, did the CFTC take any action to ensure that MF Global's heightened leverage did not pose a risk for its customers? If not, why not?

<u>Response</u>: MF Global was placed on heightened financial surveillance in March 2008 by its designated self-regulatory organization, the CME. The heightened financial surveillance required MF Global to provide the CME, on a daily basis, with a net capital computation and computations demonstrating its compliance with its obligation to segregate customer funds under Section 4d of the Commodity Exchange Act and to set-aside customer funds for trading on non-U.S. contract markets under CFTC Regulation 30.7. MF Global also filed copies of its daily capital and customer funds calculations with

the CFTC. Staff of the CME and CFTC reviewed the daily submissions to assess MF Global's compliance with the CFTC's capital and customer funds protection requirements.

5.) Who specifically was the first person within the CFTC to find out that customer funds were missing from MF Global?

Response: Both Melissa Hendrickson and Robert Wasserman of the CFTC staff received information from MF Global relating to concerns over customer funds.

6.) Who specifically told this person that customer funds were missing?

Response: Phil Cooley and Edith O'Brien provided information to Melissa Hendrickson of the CFTC staff. Robert Wasserman of the CFTC staff believes that Laurie Ferber provided him with information.

7.) How did that person become aware that customer funds were missing?

Response: Please see responses to Questions 5 and 6 above.

8.) In the week prior to MF Global's bankruptcy, how many CFTC employees were embedded at MF Global?

Response: In the week prior to MF Global's bankrupty, seven CFTC staff members were present at various times at MF Global's offices in Chicago and New York from October 27 to October 30, 2011.

9.) how many CFTC employees are currently tasked with recovering client funds at MF Global?

Response: CFTC staff are in addition to the attorneys and accountants employed by the trustee.

The number of CFTC staff members currently involved in the review and investigation of MF Global fluctuates with the amount of work required to be performed, however, the CFTC has devoted dozens of staff to the review and investigation including attorneys and examiners/auditors from various Divisions and Offices within the CFTC.

10.) when did the CFTC become aware that MF Global was using "repo to maturity" accounting?

Response: MF Global's annual report for March 31, 2010 includes a footnote No. 4, which references the use of "repo to maturity" accounting. This annual report was filed on June 1, 2010.

11.) Did the CFTC raise any objections to the Financial Industry Regulatory Authority giving Mr. Corzine a waiver from his Series 7 and Series 24 exams? If not, why not?

Response: CFTC staff does not believe that the issue of the Financial Industry Regulatory Authority ("FINRA") giving Mr. Corzine a waiver from the Series 7 or Series 24 exams was ever raised with the Commission. The Series 7 and Series 24 exams are administered by the securities industry regulators and address certain securities businesses. The exams are not related to the commodities industry or to exams administered by the National Futures Association on the Commission's behalf. FINRA would not need to consult with the CFTC regarding a waiver of the Series 7 or Series 24 exams.

12.) Bloomberg's Matthew Goldstein has reported that MF Global departed from its usual practice of using wire transfers and was paying customers in paper checks prior to its bankruptcy. Was the CFTC aware of this?

Response: Prior to the bankruptcy, staff was not aware that MF Global departed from a general practice of using wire transfers to pay customers (unless a check was specifically requested otherwise from a customer).

13.) Commentators have noted that the CFTC typically moves customer positions before a Futures Commission Merchant declares bankruptcy. Why did the CFTC not take this step prior to MF Global declaring bankruptcy?

Response: As an initial matter, while the Commission may approve the movement of customer positions, see 11 USC §764(b), and has the power to mandate that an FCM that is undercapitalized must cease doing business and transfer all customer accounts, the Commission does not have the power to mandate the transfer of accounts to a specific transferee, or to mandate that any particular transferee accept such transfer.

While moving customer positions before bankruptcy may be preferable, it is often not practicable. Thus, in all three commodity broker bankruptcies in the 21st century (Refco, Lehman, and MF Global), customer positions were moved only after bankruptcy was filed, and with the explicit approval of the bankruptcy judge pursuant to 11 U.S.C. §363, holding the transferees harmless from any undisclosed liabilities.

Senator John Thune

5) Since the CFTC and SEC were responsible for overseeing different parts of MF Global's financial activities, media reports indicate that the CFTC and SEC did not adequately share information in the days leading up to the bankruptcy of MF Global. To what extent did the CFTC and SEC share information on the financial condition and record keeping practices of MF Global prior to its collapse on October 31st?

Response: **At the end of August 2011, SEC staff contacted CFTC staff regarding MF Global's repo to maturity transactions.**

On September 19, 2011, CFTC staff held a teleconference with FINRA staff to obtain further information regarding the repo to maturity transactions.

On October 25, 2011, CFTC staff spoke with FINRA staff regarding MF Global. During this call, FINRA discussed certain additional steps it had taken to monitor MF Global.

On October 27, 2011, staff in the CFTC New York Regional office was contacted by SEC staff. CFTC staff ultimately joined the SEC staff in a meeting at MF Global that was the initiation of an SEC examination of the firm.

On October 28, 2011, CFTC staff spoke with FINRA staff regarding the status of MF Global.

On October 30, 2011, CFTC and SEC staff participated in a conference call with MF Global regarding MF Global's financial status and the production of documents related to that status.