MANAGED FUNDS ASSOCIATION

WRITTEN STATEMENT

OF

ADAM COOPER
SENIOR MANAGING DIRECTOR AND CHIEF LEGAL OFFICER,
CITADEL LLC

ON BEHALF OF
MANAGED FUNDS ASSOCIATION

For the Hearing
One Year Later - The Wall Street Reform and
Consumer Protection Act - Implementation of Title VII

BEFORE THE

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

JUNE 15, 2011

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WRITTEN STATEMENT OF MANAGED FUNDS ASSOCIATION

One Year Later - The Wall Street Reform and Consumer Protection Act - Implementation of Title VII

June 15, 2011

My name is Adam Cooper and I am Senior Managing Director and Chief Legal Officer of Citadel LLC, a global financial institution that provides asset management services and engages in a range of capital markets activities. Citadel oversees investments around the world for investors from across the world from its headquarters in Chicago and offices in other financial centers including New York, London, Hong Kong, San Francisco and Boston.

I am here today to speak on behalf of Managed Funds Association ("MFA") and its members. On their behalf, I am pleased to provide this statement in connection with the U.S. Senate Committee on Agriculture, Nutrition and Forestry's hearing held on June 15, 2011 to review implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") one year after enactment. MFA represents the majority of the world's largest hedge funds and is the primary advocate for sound business practices and industry growth for professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. MFA's members manage a substantial portion of the approximately $2 trillion invested in absolute return strategies around the world. Our members serve pensions, university endowments, and other institutions to diversify their investments, manage risk and generate reliable returns to meet their obligations to their beneficiaries.

MFA's members are among the most sophisticated institutional investors and play an important role in our financial system. They are active participants in the commodity, securities and over-the-counter ("OTC") derivatives markets. They provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to plan beneficiaries. MFA members engage in a variety of investment strategies across many different asset classes. The growth and diversification of investment funds have strengthened U.S. capital markets and provided investors with the means to diversify their investments, thereby reducing overall portfolio investment risk. As investors, MFA members help dampen market volatility by providing liquidity and pricing efficiency across many markets. Each of these functions is critical to the orderly operation of our capital markets and our financial system as a whole.

In addition, MFA members are active participants in the OTC derivatives markets, where they use swaps to, among other things, hedge risk. For example, an asset manager that has investments denominated in foreign currencies may engage in an FX swap to hedge against the risk of currency fluctuations and protect its portfolio from such related losses. As active participants in the derivatives markets, MFA members also play a critical role in enabling commercial and other institutional market participants to reduce

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their commercial or balance sheet risk through the use of swaps. For example, corporate end-users may purchase a credit default swap from a dealer to protect themselves from the default of another corporation, or a pension fund may purchase a variance swap from a dealer to protect against stock market volatility and to ensure that it can meet its future obligations to pensioners. In such scenarios, dealers generally look to balance their books by purchasing offsetting protection from market participants who may be better positioned to manage such risk, such as hedge funds. Dealers would be limited in the amount of protection they could offer their customers if there were no market participants willing to purchase or sell protection to mitigate a dealer's risk.

MFA members depend on reliable counterparties and market stability. As such, we have a strong interest in promoting the integrity and proper functioning of the OTC derivatives markets, and in ensuring that new regulations appropriately address interconnectedness and systemic risk, include adequate protections for customers' collateral and promote open and transparent markets. MFA is fully supportive of policymakers' goals to improve the functioning of the markets and protect customers by promoting central clearing of derivatives, increasing transparency and implementing other measures intended to mitigate systemic risk. MFA believes that moving to central clearing will yield immediate results by improving efficiency and competitiveness in the OTC derivatives markets as well as reducing interconnectedness and systemic risk. Such improvements in the financial markets in turn reduce the cost of capital and help drive job creation.

On behalf of MFA, I appreciate the Committee's review of the implementation of Title VII of the Dodd-Frank Act. MFA provided a number of comments to regulators, which it believes are consistent with the Committee's public policy goals and will further enhance the benefits of OTC derivatives regulation. We would like to work with the Committee, the CFTC and any other interested parties in addressing these issues, and we are committed in working towards regulations that will restore investor confidence, stabilize our financial markets and strengthen our nation's economy.

TIMELINE FOR IMPLEMENTATION OF TITLE VII RULEMAKINGS

MFA recognizes that the Dodd-Frank Act mandates that regulators promulgate a record number of new regulations within 360 days of its enactment. Throughout the legislative and regulatory processes, MFA has advocated for reform of the OTC derivatives markets. In this spirit, we have concrete recommendations that will facilitate prompt implementation of essential reforms, such as central clearing, and move the industry closer to our shared goal of reduced systemic risk and a more efficient market structure. In order to be a constructive part of the process, MFA submitted a letter to the CFTC and SEC Commissioners on March 24, 2011, providing recommendations and a detailed timeline for prompt adoption and implementation of all rules related to OTC derivatives reform. The letter is included as Annex A to this Written Statement.

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As a general matter, MFA believes that by properly ordering priorities, establishing a series of defined milestones and implementing reforms in a practical manner that focuses on the ultimate goal (*i.e.*, reducing the risk to the global financial system), the OTC derivatives market could achieve substantial progress towards key regulatory reforms, including central clearing, sooner rather than later. To that end, we believe the first two priorities should be: (i) expanding the use of central clearing for liquid ("clearable") contracts by all relevant classes of market participants; and (ii) having trade repositories receive data on both cleared and bilateral swaps. These changes would provide immediate and substantial benefits to the markets by enhancing price transparency and competition for the most liquid swap transactions. In addition, reforms, such as broad industry clearing and trade repository data, will lay the groundwork for future reforms (*e.g.*, electronic trading and trade transparency) that will provide regulators the data they need (*e.g.*, regarding liquidity and pricing) to promulgate effective rules, oversee the markets and monitor for market risks.

We do not support a "big bang" approach to implementation where all rules take effect simultaneously and almost immediately after adopted as final. We think this approach could strain the structure and resources of the financial markets, might overwhelm the staff and financial resources of regulators and could become a barrier to overall progress on reform. Instead, we recommend implementing rules using a phase-in approach based on the type of product and not the type of market participant. For example, with respect to central clearing, we expect the most liquid and standardized classes of products to be available for clearing first and, at such time, all market participants ready to clear that class of products (including customers) should be initially permitted (but not required) to clear them, as a key step toward ensuring that all relevant participants are prepared for compliance with the clearing mandate when it becomes effective. In addition, in order to allow market participants to prepare for the effectiveness of each of these phased-in rules, we suggest that the SEC and CFTC promptly release their expected plans and timing for adoption and implementation of all rulemakings.

Although as a general matter, we support moving forward on critical Title VII reforms, we are concerned about provisions in Title VII that automatically will become effective on July 16, 2011 without any rulemaking. Without the benefit of additional, related or pending CFTC interpretive guidance or rulemakings, certain of these provisions will create operational and compliance issues for MFA's members or their swap counterparties (*e.g.*, the repeal of certain provisions in Part 2 of the CFTC regulations that provide legal certainty to swap transactions). We appreciate that the CFTC is holding an open meeting to discuss the issue and that the SEC announced that they would also be taking steps to resolve these concerns. We are supportive of their efforts, although we are still evaluating the solutions that they are proposing.

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Central Clearing and Access to Clearing Significant Entities

MFA supports policymakers' efforts to reduce systemic risk by transitioning eligible markets to central clearing and by enhancing transparency. We believe that central clearing will play an essential role in reducing systemic, operational and counterparty risk. We are confident that "good" clearing (*i.e.*, clearing with objective, risk-based standards for participation and real-time trade acceptance), with open access and real-time processing, will become the foundation for competitive swap execution facilities ("SEFs") and consequent significant improvements in transparency. While we expect a bilateral market to remain for limited customized business and risk management needs, the vast majority of the volume in the OTC derivatives markets is concentrated in products that are appropriate and should be eligible for clearing.

We believe that mandatory clearing and gathering of data by swap data repositories ("SDRs"), to the extent practicable, are key first steps that will offer increased regulatory and market efficiencies, greater market transparency and competition. Since the beginning of this important debate, MFA has supported central clearing. In that vein, we urge regulators to move deliberately and promptly to ensure that *all* relevant participants in the market are afforded open access to clearing and are in a position to comply the clearing mandate as regulators phase it in.

With over three years of foundational work in OTC derivatives clearing behind us, the industry is in a good position to complete the remaining milestones to prepare for widespread clearing in the near term. Clearinghouses for credit default swaps ("CDS") and interest rate swaps ("IRS") have already been through extensive dealer-to-dealer clearing. Since 2009, IntercontinentalExchange has cleared CDS representing over $15 trillion in gross notional amounts and more than 400,000 transactions, primarily in dealer-to-dealer transactions. In addition, since 1999, LCH.Clearnet has cleared $295 trillion in gross notional amounts of dealer-to-dealer IRS in 14 currencies.

In addition, although a number of key impediments to buy-side clearing exist, buy-side participants have also undertaken significant steps to prepare for greater, open access to clearing. For example, a number of buy-side firms, including Citadel, have negotiated clearing arrangements, tested margin methodologies, tested straight-through processing and worked through a wide range of operational and reporting prerequisites to clearing in volume. Clearing members have also been working for several years now on structuring offerings to clients, including smaller clients with limited operational capacity themselves, to support widespread clearing. It makes good policy sense to capitalize on this momentum by moving forward with greater clearing generally and facilitating greater buy-side clearing.

As experienced and active market participants, we recognize that the success of central clearing and the gathering of data will depend on the structure, governance and financial soundness of derivatives clearing organizations ("DCOs"), SDRs, SEFs and

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designated contract markets ("DCMs"). Accordingly, we emphasize the need for DCOs, wherever applicable, to have transparent and replicable risk models and straight-through, real-time processing that enable fair and open access in a manner that incentivizes competition and reduces barriers to entry. Thus, from a customer protection perspective, we believe it is important to have customer representation on the governance and risk committees of DCOs because given the critical decisions such committees will make (*e.g.*, decisions about which classes of swaps the DCO is permitted to clear), they will benefit from the perspective of such significant and longstanding market participants. We also believe that to completely effectuate fair representation and balanced governance, it is critical that the CFTC adopt regulations that prohibit any one group from constituting a controlling majority of DCO boards or risk committees.

With respect to DCOs, DCMs and SEFs, MFA appreciates that the CFTC has proposed rules intended to ensure that these crucial entities are governed in a manner that prevents conflicts of interest from undermining the CFTC's mission to reduce risk, increase transparency and promote market integrity within the financial system. We very much appreciate that the proposed rules reflect the CFTC's detailed appraisal of market concerns, and we believe the rules are a critical step towards mitigating conflicts of interest at DCOs, DCMs and SEFs while preserving their competitiveness and ability to provide the best possible services to the markets.

With respect to SDRs, we emphasize that their role as data collectors is critical to providing transparency and greater information about the financial markets. We believe that the data received by SDRs and shared with regulators will form an essential component of the regulatory process by providing regulators with the information necessary to refine their regulations and to effectively oversee the markets and market participants. Such data collection efforts are an important first step towards the long-term goal of real-time public reporting.

CAPITAL AND MARGIN REQUIREMENTS

The Dodd-Frank Act requires the Prudential Regulators to impose capital and margin requirements on market participants that are subject to their regulation as swap dealers ("SDs") or major swap participants ("MSPs", and together with SDs, Covered Swap Entities). MFA strongly supports measures to reduce systemic risk in the swap markets, including the imposition of balanced, risk-based margin requirements, but we want to ensure that the Prudential Regulators' proposed capital and margin requirements for Covered Swap Entities' uncleared swaps promote a balanced approach between decreasing unnecessary risk and maintaining necessary liquidity in swap markets.

In particular, we are concerned that although the Prudential Regulators' proposed margin requirements do not prevent Covered Swap Entities from posting variation margin to their financial entity counterparties on their uncleared swaps, they also do not include an express requirement that Covered Swap Entities do so. Rather, the Prudential

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Regulators' proposed requirements create a potential misperception that it is neither necessary nor important for a Covered Swap Entity to post variation margin. MFA is concerned that Covered Swap Entities may use the presumption created by the Proposed Rules to retreat from current market "best practice" of posting variation margin to their counterparties. The ability of market participants to accumulate an unlimited amount of unsecured obligations to counterparties was one of the primary causes of the recent financial crisis and was why entities such as AIG were "too big to fail". As a result, the failure to mitigate current counterparty credit exposures by requiring Covered Swap Entities to exchange variation margin could cause serious harm to the financial system. Moreover, we believe that it is important that bilateral markets be required to maintain the discipline of two-way variation margin as a step for them to transition, to the extent possible, to clearing.

We note also that proposed margin and segregation of collateral rules may, going forward, prohibit arrangements that currently allow netting of a customer's cleared and uncleared positions as well as swap and non-swap positions. We are concerned that such effects will: (i) increase systemic risk by eliminating netting offsets that reduce risk; (ii) restrict the ability of market participants to make efficient use of their capital; and (iii) increase complexity and settlement risk.

MFA is still reviewing and analyzing the Prudential Regulators' proposal as well as CFTC's similar proposed capital and margin requirements for SDs and MSPs subject to its regulation. Therefore, we would appreciate the opportunity to provide our written comment letters to the Committee as an addendum to our testimony once they are complete.

SEGREGATION OF CUSTOMER COLLATERAL

MFA supports measures aimed at increasing protections for customer assets posted as collateral for swaps. For cleared swaps, MFA applauds policymakers' decision in the legislation to prohibit futures commission merchants ("FCMs") from treating a customer's margin as its own and from commingling their proprietary assets with those of their customers. We agree that segregation of assets is a critical component to the effective functioning of the mandatory clearing regime and necessary to ensure that customer assets are protected in the event of the FCM's insolvency. The Dodd Frank Act provides critical support for clearing by expressly confirming that a clearing member must fully segregate its customer assets relating to a swap from its own assets under applicable bankruptcy rules.

MFA members have been active participants in the policy discussion about the best specific segregation model to apply to cleared customer assets. As a result, we applaud the CFTC for proposing to adopt the more protective Full Legal Segregation Model (over the Legal Segregation with Recourse Model or the Futures Model). We believe that the Full Legal Segregation model provides a high degree of protection to

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customer collateral as well as increased assurance that customers will be able to promptly transfer their positions and collateral in the event of their clearing member's default, while hopefully avoiding the potentially substantial cost and delay that might be entailed in shifting to a model of complete legal and operational partitioning.

However, we are concerned that the CFTC's proposed segregation rules would prohibit an FCM from imposing, or permitting the imposition of, a lien on the collateral of a cleared swaps customer, even when the lien is imposed at the request of the customer itself. The purpose of this prohibition is to preempt the claim of an FCM's creditor against any customer's collateral in the event of the FCM's insolvency, and thereby, help ensure the portability of such collateral. While we support the efforts of the CFTC to protect customers and the portability of their assets, we think it critical that the CFTC eliminate this restriction and preserve customers' ability to initiate negotiated arrangements that permit such liens.

DEFINITION OF MAJOR SWAP PARTICIPANT

The legislation provides a definition for the term "major swap participant", which is a new category of market participant. Because entities that become MSPs will be subject to significant regulatory obligations, including new capital requirements as well as a number of business conduct and other requirements, the way in which regulators define this important term will significantly affect the evolving markets for swaps and the conduct of participants in these markets. MFA believes that the MSP designation should capture non-dealer market participants whose swap positions may adversely affect market stability. In addition, we strongly support the need for enhanced market standards and consistency to prevent anomalous and dangerous practices, such as AIG's, and which mitigate the excessive build-up of counterparty and systemic risk.

The legislation gives the CFTC, jointly with the SEC, (together with the CFTC, the "Commissions"), the authority to define certain important terms that form part of the MSP definition, such as "substantial position", "substantial counterparty exposure" and "highly leveraged". The Commissions have jointly issued a proposed rule providing different tests and threshold levels for these terms in order to clarify which entities are MSPs.

MFA supports the Commissions' general approach to the MSP definition and the tests for the different terms. However, we think it would be useful for the Commissions first to conduct an informal survey to determine which types of market participants will likely meet the definition and whether the proposed definitional thresholds are appropriate as proposed. We think the Commissions can conduct such a survey without incurring significant costs or delaying the progression of the regulations. In addition, we would appreciate more clarity around the tests, such as on (i) the effects of over-collateralization or cleared swap positions on the calculations, and (ii) the treatment of cleared swaps for purposes of the potential future exposure test. We think clarity is

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essential to ensure that there is a bright line where market participants have certainty as to whether they need to register as an MSP. Lastly, to be effective going forward, the Commissions need to ensure that their proposed rules take into account reasonable projections about market activity and growth, so that the rules capture the intended market participants, consistent with the goal of monitoring and overseeing entities that could pose systemic risk to the United States financial markets.

SWAP EXECUTION FACILITIES

The legislation defines a "swap execution facility" (a "SEF") as "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." However, we are concerned that the CFTC is interpreting the definition too narrowly because its proposed rule requires that to qualify as a SEF a company must offer a "many-to-many" quote platform (*i.e.*, a trading platform where a market participant must transmit a request for a buy or sell quote to no less than five market participants). We believe that the mandated minimum number of request-for-quote recipients is unnecessary and could harm customers' ability to execute these transactions efficiently.

MFA believes that each SEF trading platform needs to be appropriate for the product type it will execute, as the characteristics and corresponding trading needs vary. In addition, we believe that permitting a broad range of swap trading platforms (subject to the requirements under the legislation) would benefit investors and the markets by increasing regulatory and market efficiencies, promoting market-based competition among providers and enabling greater transparency over time and across a variety of products. Therefore, we would appreciate it if policymakers could provide guidance to the CFTC on Congress's intended interpretation of the definition, so that the CFTC's final rules will preserve flexibility and opportunity for variety and organic development among SEF trading platforms to the benefit of all market participants and consistent with the approach in other markets.

In addition, the CFTC's proposed rules relating to SEFs also raise a number of issues related to block trade sizes. The CFTC's proposed definition of block size has such a high threshold that only very large trades would qualify as block trades. We believe that it is important that the CFTC define the notion of block size in a way that allows a sufficient number of block trades and illiquid and bespoke swaps to continue to take place. As a result, MFA believes that with respect to the determination of block trade sizes for swaps, regulators should obtain empirical evidence before establishing block trade levels for each swap class *(e.g.*, relating to duration, underlying reference entity, etc.), so as to ensure that the CFTC's final rules on block trades do not disrupt markets or reduce liquidity. In addition, once the CFTC has the evidence to proceed, we believe that the CFTC's determinations relating to block size should take into account the

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varying characteristics of liquidity of the market for a particular instrument and the characteristics of the relevant class or product.

In this context, we refer again to our proposed implementation timeline, which sequences broad access to and utilization of clearing ahead of requirements to trade on SEFs and requirements for individual real-time trade reporting. We believe that by first prioritizing clearing and reporting to regulators, regulators will obtain valuable information regarding trade volumes, pricing and liquidity, which they can then use to determine subsequent transparency requirements and to create the foundation for SEFs to offer their facilities on an open and competitive basis. As leading buy-side participants, we currently see considerable preparation by a range of existing and start-up SEFs seeking to capitalize on the opportunities created by Dodd Frank, which will become concrete once suitable clearing models become available that set out the requirements for open access.

POSITION LIMITS

MFA recognizes that the Dodd-Frank Act expanded the CFTC's authority to set position limits, as the Commission finds necessary to deter and prevent excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of a commodity. Academic and governmental studies[1] and real world examples have not found excessive speculation to be the cause of recent market volatility and show that policies restricting investor access to derivatives markets impair commercial participants' ability to hedge and restrict the use of risk management tools. Nevertheless, concerns with the effectiveness of position limits aside, we have strong concern with the

[1] *See* CFTC Inter-Agency Task Force on Commodity Markets—Interim Report on Crude Oil (July 2008); GAO Briefings to the House Committee on Agriculture on Issues Involving the Use of Futures Markets to Invest in Commodity Indexes (Dec. 2008); International Organization of Securities Commission's Technical Committee (IOSCO) Final Report (Mar. 2009); IMF World Economic Outlook (Oct. 2008); HM Treasury Global Commodities: A long term vision for stable, secure and sustainable global markets (June 2008); CME Group white paper "Excessive Speculation and Position Limits in Energy Derivatives Markets," available at http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf; *Dr Evil, or drivel? The charge-sheet against commodity speculators is flimsy*, Economist, November 11, 2010 ("In fact there is little empirical evidence that investors cause more than fleeting distortions to commodity prices. The most persuasive explanation for the rises and falls of commodities is demand and supply."); Irwin, Scott. H., and Sanders, Dwight R. (2010), The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing; "With Better Data, Better Understanding" (Jan. 27, 2009); Lawrence Eagles, J.P. Morgan; CFTC Staff Report on Commodity Swap Dealers & Index Traders (Sept. 2008); "Commodity Price and Futures Positions" (Dec. 16, 2009), Ruy Ribero, Lawrence Eagles and Nicholas von Solodkoff, J.P. Morgan; "We can safely say there is no indication in this data of the fact speculators are pushing the price of oil," Christophe Barret, global oil analyst at Credit Agricole, quoted in Energy Risk (Apr 13, 2010), available at http://www.risk.net/energy-risk/news/1600919/cftc-speculators-influence-commodity-markets; Prepared Testimony of Philip K. Verleger, Jr., Haskayne School of Management, University of Calgary, PKVerleger LLC, to Commodity Futures Trading Commission on The Role of Speculators in Setting the Price of Oil (Aug. 5, 2009); "Speculators Cleared in U.K. Oil Volatility" (July 28, 2009), *The Wall Street Journal*; CFTC Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, *supra* note 11; and Büyükşahin, Haigh, Harris, Overdahl and Robe, Fundamentals, Trader Activity and Derivative Pricing (December 4, 2008), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/marketreportenergyfutures.pdf.

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workability of the CFTC's currently proposed rules on position limits ("Proposed Rules") in many respects.

The CFTC's Proposed Rules depart from its longstanding policy of aggregating positions based on ownership, control of trading decisions and trading in concert. With respect to position limits, Section 4a(a) of the Commodity Exchange Act provides:

> In determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

Under current regulation, the CFTC provides relief from having to aggregate accounts or positions based on ownership where discretion over trading is granted to an independent third party, because the beneficial owners in these cases do not directly or indirectly control the trading of the accounts or positions involved, and they are often unaware of the specific orders.

The CFTC has given no reason to depart from its longstanding disaggregation policy for independent account controllers, nor do we believe it is consistent with the spirit of the law. The Proposed Rules' elimination of the disaggregation policy for independent account controllers would generally eliminate the ability of firms to disaggregate different parts of their business or different passive accounts that follow different investment strategies. The ability to invest in a variety of strategies and obtain access to a variety of independent managers is particularly important to larger passive investors, such as pension plans.

If asset managers cannot disaggregate independent account controllers for purposes of position limits, asset managers and/or independent account controllers to whom they allocate assets may be compelled to reduce their participation in the futures markets, and/or shift their business to other venues, resulting in a significant reduction of market liquidity on U.S. futures exchanges. We also note that the Proposed Rules would effectively require otherwise independent trading operations of commonly owned enterprises to communicate with each other as to their trading positions and intentions so as to avoid violating position limits. A trader, such as a pension plan, also would be required to signal to its independent managers the positions of its other independent managers to ensure that the trader does not exceed the position limits. Such communications would raise confidentiality issues and the potential for trading in concert, which is precisely the sort of behavior that the Proposed Rules seek to avoid.

MFA believes that, when the CFTC exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of futures markets to perform their fundamental price discovery, risk transfer and risk management

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functions, which depend on the existence of liquid, fair, and competitive markets. In this way, position limits regulation is less likely to unintentionally reduce market liquidity and the ability of market participants to appropriately diversify and hedge risk. Accordingly, we recommend that the Committee encourage the CFTC to maintain its longstanding disaggregation policy for independent account controllers with respect to position limits.

INTERNATIONAL

As the Committee is aware, European, Asian and other policymakers are currently working on their proposed regulation with respect to OTC derivatives to complement the market reform occurring in the U.S. However, considerable uncertainty exists with regard to the extraterritorial application of those proposed regulations, particularly the European regulation. MFA respectfully urges U.S. policymakers and regulators to enhance their coordination with their European and other counterparts to ensure that any regulatory reform is consistent, where applicable, and addresses counterparty and systemic risk, while permitting access to, and competition among, central counterparties organized in countries outside of the relevant jurisdiction.

In particular, it is important that approval of third country central counterparties not become unreasonably difficult to obtain. Otherwise, there is potential that the derivatives market will become fragmented along jurisdictional lines, which could cause significant harm to the markets by, among other things, impeding competition, impairing portability and eventual interoperability, limiting participant access to clearing and their ability to operate in certain jurisdictions, and ultimately creating artificial barriers across a global marketplace and instrument type.

While we recognize that the regulatory regimes of different countries may need to diverge to a certain extent, inconsistent regulations will be costly, burdensome and, in some cases, make it impossible for market participants to comply with both regimes. We are appreciative of the ongoing joint efforts of U.S. and non-U.S. regulators to avoid any disharmony between the regulations, to the extent possible, as well as the imposition of duplicative regulation and encourage continued efforts in this regard.

CONCLUSION

On behalf of MFA, I appreciate the Committee's review of the implementation of Title VII of the Dodd-Frank Act one year after enactment. As discussed, MFA believes that OTC derivatives regulation has the potential benefits of reducing systemic and counterparty risk, and enhancing market efficiency, competition and investor protection. We recommend that critical OTC derivatives reforms, such as central clearing, move

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forward promptly by ordering priorities, using defined interim milestones and implementing reforms using a product-by-product phase in approach. We believe that smart regulations that parallel market practice will enhance oversight and compliance, support the risk management needs of market participants and further promote innovation and competition.

MFA is committed to working with Members and staff of the Committee and regulators to restore investor confidence, enhance our regulatory system, stabilize our financial markets and strengthen our nation's economy. Thank you for the opportunity to appear before you today. I would be happy to answer any questions that you may have.

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