EXAMINING LEGISLATIVE IMPROVEMENTS TO TITLE VII OF THE DODD-FRANK ACT

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

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EXAMINING LEGISLATIVE IMPROVEMENTS TO TITLE VII OF THE DODD-FRANK ACT

THURSDAY, MARCH 14, 2013

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

The Committee met, pursuant to call, at 10:00 a.m., in Room 1300 of the Longworth House Office Building, Hon. Frank D. Lucas [Chairman of the Committee] presiding.

Members present: Representatives Lucas, Neugebauer, Conaway, Thompson, Austin Scott of Georgia, Tipton, Crawford, DesJarlais, Gibson, Hartzler, Noem, Benishek, Denham, Fincher, LaMalfa, Hudson, Davis, Collins, Yoho, Peterson, David Scott of Georgia, Walz, Schrader, McGovern, DelBene, Negrete McLeod, Vela, Nolan, Gallego, Enyart, Vargas, Bustos, Maloney, and Courtney.

Staff present: Debbie Smith, Jason Goggins, John Porter, Josh Mathis, Kevin Kramp, Lauren Sturgeon, Matt Schertz, Nicole Scott, Suzanne Watson, Tamara Hinton, Anne Simmons, C. Clark Ogilvie, Liz Friedlander, John Konya, and Caleb Crosswhite.

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

The CHAIRMAN. This hearing of the Committee on Agriculture to examine legislative improvements to Title VII of the Dodd-Frank Act will come to order. Thank you for being here today.

In a way we have already had this hearing during the last Congress. In fact, we held more than a dozen hearings on Dodd-Frank Act during the last Congress with dozens of witnesses, and we have discussed all of the bills or topics that are on the agenda today during those past hearings.

Unfortunately, the reason we are still talking about the very same issues is because the same concerns still exist with parts of Dodd-Frank. We stand to harm significant portions of our economy if these issues are not addressed in legislative fixes.

Since the start of 2011, the feedback we have heard all across the country has been fairly consistent; farmers, ranchers, financial firms, main street businesses are worried about some of the unintended consequences of Dodd-Frank rules. We have heard from public power companies that might not be able to hedge against volatile energy prices because their counterparties are walking away. As a result, energy prices could rise for millions of Americans, an unacceptable result of what was certainly never contemplated when Dodd-Frank was written to reform our financial system.

And we have heard from manufacturers who employ hundreds of thousands of Americans that they will have to alter their business models because they may be required to post margin on important risk management trades or on their very own internal transactions. It boils down to this. Some of these regulations could make using derivatives so expensive that businesses will be forced to stop using them to hedge against risk. That increases costs for consumers and reduces stability in the marketplace. This is completely contrary to the intent of the original Dodd-Frank legislation.

Today we will review legislation that is balanced, that our balanced proposals that ensure that legislation is implemented in the manner that Congress intended or provides a technical fix to ensure that Dodd-Frank does not interrupt the markets or harm the economy. It is good to note that this Committee heard from top regulators from Japan and the European Union just last December, who warned that without better coordination between the CFTC and international regulators there will be global fragmentation of the derivatives markets. That cannot be allowed to happen.

One of today's bills, a discussion draft, will directly address that issue in a commonsense manner that Dodd-Frank should have already included. It is very important to note that every single bill we will discuss here today is bipartisan with Republicans and Democrats both on the Agriculture Committee and the Financial Services Committee supporting them. They are bipartisan because they contain commonsense tweaks to ensure that Dodd-Frank does not unnecessarily burden our agricultural producers, job creators, local utilities, financial institutions, and small businesses.

Again, all of these bills are intended to restore the balance that I believe can exist between sound regulation and a healthy economy. I look forward to advancing all of them in a bipartisan fashion.

[The prepared statement of Mr. Lucas follows:]

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

Thank you all for being here today.

In a way, we have already had this hearing during the last Congress. In fact, we held more than a dozen hearings on the Dodd-Frank Act during the last Congress with dozens of witnesses. And, we have discussed all of the bills or topics that are on our agenda today during past hearings.

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Since the start of 2011, the feedback we have heard all across the country has been fairly consistent. Farmers, ranchers, financial firms, and Main Street businesses are worried about the unintended consequences of Dodd-Frank rules.

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And we've heard from manufacturers—who employ hundreds of thousands of Americans—that that they will have to alter their business models because they may be required to post margin on important risk management trades or on their very own internal transactions.

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It is good to note that this Committee heard from top regulators from Japan and the European Union just last December who warned that without better coordination between the CFTC and international regulators, there will be global fragmentation of the derivatives markets. That cannot be allowed to happen. One of today's bills—a discussion draft—will directly address that issue in a common-sense manner that Dodd-Frank should have already included.

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Again, all of these bills are intended to restore the balance that I believe can exist between sound regulation and a healthy economy.

I look forward to advancing all of them in a bipartisan fashion.

I now will turn to the Ranking Member to make his opening statement.

LEGISLATION

H.R. 634, Business Risk Mitigation and Price Stabilization Act of 2013

I

113TH CONGRESS
1ST SESSION

H. R. 634

To provide end user exemptions from certain provisions of the Commodity Exchange Act and the Securities Exchange Act of 1934, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 13, 2013

Mr. GRIMM (for himself, Mr. PETERS of Michigan, Mr. AUSTIN SCOTT of Georgia, and Mr. MCINTYRE) introduced the following bill; which was referred to the Committee on Financial Services, and in addition to the Committee on Agriculture, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To provide end user exemptions from certain provisions of the Commodity Exchange Act and the Securities Exchange Act of 1934, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Business Risk Mitigation and Price Stabilization Act of 2013".

SEC. 2. MARGIN REQUIREMENTS.

(a) COMMODITY EXCHANGE ACT AMENDMENT.—Section 4s(e) of the Commodity Exchange Act (7 U.S.C. 6s(e)), as added by section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following new paragraph:

"(4) APPLICABILITY WITH RESPECT TO COUNTERPARTIES.—The requirements of paragraphs (2)(A)(ii) and (2)(B)(ii) shall not apply to a swap in which a counterparty qualifies for an exception under section 2(h)(7)(A) or satisfies the criteria in section 2(h)(7)(D).".

(b) SECURITIES EXCHANGE ACT AMENDMENT.—Section 15F(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(e)), as added by section 764(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following new paragraph:

"(4) APPLICABILITY WITH RESPECT TO COUNTERPARTIES.—The requirements of paragraphs (2)(A)(ii) and (2)(B)(ii) shall not apply to a security-based swap in which a counterparty qualifies for an exception under section 3C(g)(1) or satisfies the criteria in section 3C(g)(4).".

SEC. 3. IMPLEMENTATION.

The amendments made by this Act to the Commodity Exchange Act shall be implemented—

(1) without regard to—

(A) chapter 35 of title 44, United States Code; and

(B) the notice and comment provisions of section 553 of title 5, United States Code;

(2) through the promulgation of an interim final rule, pursuant to which public comment will be sought before a final rule is issued; and

(3) such that paragraph (1) shall apply solely to changes to rules and regulations, or proposed rules and regulations, that are limited to and directly a consequence of such amendments.

○

H.R. 677, Inter-Affiliate Swap Clarification Act

I

113TH CONGRESS
1ST SESSION

H. R. 677

To exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 13, 2013

Mr. STIVERS (for himself, Ms. FUDGE, Ms. MOORE, Mr. GIBSON, and Mr. SCHWEIKERT) introduced the following bill; which was referred to the Committee on Financial Services, and in addition to the Committee on Agriculture, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Inter-Affiliate Swap Clarification Act''.

SEC. 2. TREATMENT OF AFFILIATE TRANSACTIONS.

(a) COMMODITY EXCHANGE ACT AMENDMENTS.—

(1) TREATMENT OF AFFILIATE TRANSACTIONS.—Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), as added by section 721(a)(21) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following:

"(G) TREATMENT OF AFFILIATE TRANSACTIONS.—

"(i) IN GENERAL.—For the purposes of any clearing and execution requirements under section 2(h) and any applicable margin and capital requirements of section 4s(e) and for purposes of defining 'swap dealer' or 'major swap participant', and reporting requirements other than those set forth in clause (ii), the term 'swap' does not include any agreement, contract, or transaction that—

"(I) would otherwise be included as a 'swap' under subparagraph (A); and

"(II) is entered into by parties, neither of which is a 'swap dealer' that is an insured depository institution or a 'major swap participant' that is an insured depository institution, that report information or prepare financial statements on a consolidated basis, or for which a company affiliated with both parties reports information or prepares financial statements on a consolidated basis.

"(ii) REPORTING.—All agreements, contracts, or transactions described in clause (i) shall be reported to either a swap data repository, or, if there is no swap data repository that would accept such agreements, contracts, or transactions, to the Commission pursuant to section 4r, or to a swap data repository or to the Commission pursuant to section 2(h)(5), within such time period as the Commission may by rule or regulation prescribe. Nothing in this subparagraph shall prohibit the Commission from establishing public reporting requirements for covered transactions between affiliates as described in sections 23A and 23B of the Federal Reserve Act in a manner consistent with rules governing the treatment of such covered transactions pursuant to section 2(a)(13) of this Act.

"(iii) PROTECTION OF INSURANCE FUNDS.—Nothing in this subparagraph shall be construed to prevent the regulator of a Federal or State insurance fund or guaranty fund from exercising its other existing authority to protect the integrity of such a fund, except that such regulator shall not subject agreements, contracts, or transactions described in clause (i) to clearing and execution requirements under section 2 of this Act, to any applicable margin and capital requirements of section 4s(e) of this Act, or to reporting requirements of title VII of Public Law 111–203 other than those set forth in clause (ii) of this subparagraph.

"(iv) PRESERVATION OF FEDERAL RESERVE ACT AUTHORITY.—Nothing in this subparagraph shall exempt a transaction described in this subparagraph from sections 23A or 23B of the Federal Reserve Act or implementing regulations thereunder.

"(v) PRESERVATION OF FEDERAL AND STATE REGULATORY AUTHORITIES.—Nothing in this subparagraph shall affect the Federal banking agencies' safety-and-soundness authorities over banks established in law other than title VII of Public Law 111–203 or the authorities of State insurance regulators over insurers, including the authority to impose capital requirements with regard to swaps. For purposes of this clause, the term 'bank' shall be defined pursuant to section 3(a)(6) of the Securities Exchange Act of 1934, 'insurer' shall be defined pursuant to title V of Public Law 111–203, and 'swap' shall be defined pursuant to title VII of Public Law 111–203.

"(vi) PREVENTION OF EVASION.—The Commission may prescribe rules under this subparagraph (and issue interpretations of such rules) as determined by the Commission to be necessary to include in the definition of swaps under this paragraph any agreement, contract, or transaction that has been structured to evade the requirements of this Act applicable to swaps.''.

(2) TREATMENT OF AFFILIATES.—Section 2(h)(7)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(D)(i)), as added by section 723(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended to read as follows:

''(i) IN GENERAL.—An affiliate of a person that qualifies for an exception under subparagraph (A) (including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the person) may qualify for the exception only if the affiliate enters into the swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity.''.

(b) SECURITIES EXCHANGE ACT OF 1934 AMENDMENTS.—

(1) TREATMENT OF AFFILIATE TRANSACTIONS.—Section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)), as added by section 761(a)(6) of the Dodd-Frank Wall

Street Reform and Consumer Protection Act, is amended by adding at the end the following:

"(F) TREATMENT OF AFFILIATE TRANSACTIONS.—

"(i) IN GENERAL.—For the purposes of any clearing and execution requirements under section 3C and any applicable margin and capital requirements of section 15F(e), and for purposes of defining 'security-based swap dealer' or a 'major security-based swap participant', and reporting requirements other than those set forth in clause (ii), the term 'security-based swap' does not include any agreement, contract, or transaction that—

"(I) would otherwise be included as a 'security-based swap' under subparagraph (A); and

"(II) is entered into by parties, neither of which is a 'security-based swap dealer' that is an insured depository institution or a 'major security-based swap participant' that is an insured depository institution, that report information or prepare financial statements on a consolidated basis, or for which a company affiliated with both parties reports information or prepares financial statements on a consolidated basis.

"(ii) REPORTING.—All agreements, contracts, or transactions described in clause (i) shall be reported to either a security-based swap data repository, or, if there is no security-based swap data repository that would accept such agreements, contracts, or transactions, to the Commission pursuant to section 13A, within such time period as the Commission may by rule or regulation prescribe.

"(iii) PRESERVATION OF FEDERAL RESERVE ACT AUTHORITY.—Nothing in this subparagraph shall exempt a transaction described in this subparagraph from sections 23A or 23B of the Federal Reserve Act or implementing regulations thereunder.

"(iv) PROTECTION OF INSURANCE FUNDS.—Nothing in this subparagraph shall be construed to prevent the regulator of a Federal or State insurance fund or guaranty fund from exercising its other existing authority to protect the integrity of such a fund, except that such regulator shall not subject security-based swap transactions between affiliated companies to clearing and execution requirements under section 3C, to any applicable margin and capital requirements of section 15F(e), or to reporting requirements of title VII of Public Law 111–203 other than those set forth in clause (ii).

"(v) PRESERVATION OF FEDERAL AND STATE REGULATORY AUTHORITIES.—Nothing in this subparagraph shall affect the Federal banking agencies' safety-and-soundness authorities over banks established in law other than title VII of Public Law 111–203 or the authorities of State insurance regulators over insurers, including the authority to impose capital requirements with regard to security-based swaps. For purposes of this clause, the term 'bank' shall be defined pursuant to section 3(a)(6) of the Securities Exchange Act of

1934, 'insurer' shall be defined pursuant to title V of Public Law 111–203, and 'security-based swap' shall be defined pursuant to title VII of Public Law 111–203.

"(vi) PREVENTION OF EVASION.—The Commission may prescribe rules under this subparagraph (and issue interpretations of such rules) as determined by the Commission to be necessary to include in the definition of security-based swap under this paragraph any agreement, contract, or transaction that has been structured to evade the requirements of this Act applicable to security-based swaps.".

(2) TREATMENT OF AFFILIATES.—Section 3C(g)(4)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(4)(A)), as added by section 763(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended to read as follows:

"(i) IN GENERAL.—An affiliate of a person that qualifies for an exception under this subsection (including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the person) may qualify for the exception only if the affiliate enters into the security-based swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity.''.

○

H.R. 742, Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013

I

113TH CONGRESS
1ST SESSION

H. R. 742

To amend the Securities Exchange Act of 1934 and the Commodity Exchange Act to repeal the indemnification requirements for regulatory authorities to obtain access to swap data required to be provided by swaps entities under such Acts.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 15, 2013

Mr. CRAWFORD (for himself, Ms. MOORE, Mr. SEAN PATRICK MALONEY of New York, and Mr. HUIZENGA of Michigan) introduced the following bill; which was referred to the Committee on Agriculture, and in addition to the Committee on Financial Services, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To amend the Securities Exchange Act of 1934 and the Commodity Exchange Act to repeal the indemnification requirements for regulatory authorities to obtain access to swap data required to be provided by swaps entities under such Acts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013''.

SEC. 2. REPEAL OF INDEMNIFICATION REQUIREMENTS.

(a) DERIVATIVES CLEARING ORGANIZATIONS.—Section 5b(k)(5) of the Commodity Exchange Act (7 U.S.C. 7a–1(k)(5)) is amended to read as follows:

''(5) CONFIDENTIALITY AGREEMENT.—Before the Commission may share information with any entity described in paragraph (4), the Commission shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 8 relating to the information on swap transactions that is provided.''.

(b) SWAP DATA REPOSITORIES.—Section 21(d) of the Commodity Exchange Act (7 U.S.C. 24a(d)) is amended to read as follows:

''(d) CONFIDENTIALITY AGREEMENT.—Before the swap data repository may share information with any entity described in subsection (c)(7), the swap data repository shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 8 relating to the information on swap transactions that is provided.''.

(c) SECURITY-BASED SWAP DATA REPOSITORIES.—Section 13(n)(5)(H) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(n)(5)(H)) is amended to read as follows:

"(H) CONFIDENTIALITY AGREEMENT.—Before the security-based swap data repository may share information with any entity described in subparagraph (G), the security-based swap data repository shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 24 relating to the information on security-based swap transactions that is provided.".

(d) EFFECTIVE DATE.—The amendments made by this Act shall take effect as if enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111–203) on July 21, 2010.

○

H.R. 992, Swaps Regulatory Improvement Act

I

113TH CONGRESS
1ST SESSION

H. R. 992

To amend provisions in section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to Federal assistance for swaps entities.

IN THE HOUSE OF REPRESENTATIVES

MARCH 6, 2013

Mr. HULTGREN (for himself, Mr. HIMES, Mr. HUDSON, and Mr. SEAN PATRICK MALONEY of New York) introduced the following bill; which was referred to the Committee on Financial Services, and in addition to the Committee on Agriculture, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To amend provisions in section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to Federal assistance for swaps entities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ‘‘Swaps Regulatory Improvement Act’’.

SEC. 2. REFORM OF PROHIBITION ON SWAP ACTIVITY ASSISTANCE.

Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 8305) is amended—

(1) in subsection (b)—

(A) in paragraph (2)(B), by striking ''insured depository institution'' and inserting ''covered depository institution''; and

(B) by adding at the end the following:

''(3) COVERED DEPOSITORY INSTITUTION.—The term 'covered depository institution' means—

''(A) an insured depository institution, as that term is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); and

''(B) a United States uninsured branch or agency of a foreign bank.'';

(2) in subsection (c)—

(A) in the heading for such subsection, by striking ''INSURED'' and inserting ''COVERED'';

(B) by striking ''an insured'' and inserting ''a covered'';

(C) by striking ''such insured'' and inserting ''such covered''; and

(D) by striking ''or savings and loan holding company'' and inserting ''savings and loan holding company, or foreign banking organization (as such term is defined under Regulation K of the Board of Governors of the Federal Reserve System (12 C.F.R. 211.21(o)))'';

(3) by amending subsection (d) to read as follows:

''(d) ONLY BONA FIDE HEDGING AND TRADITIONAL BANK ACTIVITIES PERMITTED.—

''(1) IN GENERAL.—The prohibition in subsection (a) shall not apply to any covered depository institution that limits its swap and security-based swap activities to the following:

''(A) HEDGING AND OTHER SIMILAR RISK MITIGATION ACTIVITIES.—Hedging and other similar risk mitigating activities directly related to the covered depository institution's activities.

''(B) NON-STRUCTURED FINANCE SWAP ACTIVITIES.—Acting as a swaps entity for swaps or security-based swaps other than a structured finance swap.

''(C) CERTAIN STRUCTURED FINANCE SWAP ACTIVITIES.—Acting as a swaps entity for swaps or security-based swaps that are structured finance swaps, if—

"(i) such structured finance swaps are undertaken for hedging or risk management purposes; or

"(ii) each asset-backed security underlying such structured finance swaps is of a credit quality and of a type or category with respect to which the prudential regulators have jointly adopted rules authorizing swap or security-based swap activity by covered depository institutions.

"(2) DEFINITIONS.—For purposes of this subsection:

"(A) STRUCTURED FINANCE SWAP.—The term 'structured finance swap' means a swap or security-based swap based on an asset-backed security (or group or index primarily comprised of asset-backed securities).

"(B) ASSET-BACKED SECURITY.—The term 'asset-backed security' has the meaning given such term under section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).";

(4) in subsection (e), by striking "an insured" and inserting "a covered"; and

(5) in subsection (f)—

(A) by striking "an insured depository" and inserting "a covered depository"; and

(B) by striking "the insured depository" each place such term appears and inserting "the covered depository".

○

H.R. 1003, To improve consideration by the Commodity Futures Trading Commission of the costs and benefits of its regulations and orders.

I

113TH CONGRESS
1ST SESSION

H. R. 1003

To improve consideration by the Commodity Futures Trading Commission of the costs and benefits of its regulations and orders.

IN THE HOUSE OF REPRESENTATIVES

MARCH 6, 2013

Mr. CONAWAY (for himself, Mr. DAVID SCOTT of Georgia, Mr. JORDAN, Mr. MCHENRY, and Mr. GARRETT) introduced the following bill; which was referred to the Committee on Agriculture

---

A BILL

To improve consideration by the Commodity Futures Trading Commission of the costs and benefits of its regulations and orders.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CONSIDERATION BY THE COMMODITY FUTURES TRADING COMMISSION OF THE COSTS AND BENEFITS OF ITS REGULATIONS AND ORDERS.

Section 15(a) of the Commodity Exchange Act (7 U.S.C. 19(a)) is amended by striking paragraphs (1) and (2) and inserting the following:

"(1) IN GENERAL.—Before promulgating a regulation under this Act or issuing an order (except as provided in paragraph (3)), the Commission, through the Office of the Chief Economist, shall assess the costs and benefits, both qualitative and quantitative, of the intended regulation and propose or adopt a regulation only on a reasoned determination that the benefits of the intended regulation justify the costs of the intended regulation (recognizing that some benefits and costs are difficult to quantify). It must measure, and seek to improve, the actual results of regulatory requirements.

"(2) CONSIDERATIONS.—In making a reasoned determination of the costs and the benefits, the Commission shall evaluate—

"(A) considerations of protection of market participants and the public;

"(B) considerations of the efficiency, competitiveness, and financial integrity of futures and swaps markets;

"(C) considerations of the impact on market liquidity in the futures and swaps markets;

"(D) considerations of price discovery;

"(E) considerations of sound risk management practices;

"(F) available alternatives to direct regulation;

"(G) the degree and nature of the risks posed by various activities within the scope of its jurisdiction;

"(H) whether, consistent with obtaining regulatory objectives, the regulation is tailored to impose the least burden on society, including market participants, individuals, businesses of differing sizes, and other entities (including small communities and governmental entities), taking into account, to the extent practicable, the cumulative costs of regulations;

"(I) whether the regulation is inconsistent, incompatible, or duplicative of other Federal regulations;

"(J) whether, in choosing among alternative regulatory approaches, those approaches maximize net benefits (including potential economic, environmental, and other benefits, distributive impacts, and equity); and

"(K) other public interest considerations.".

○

H.R. 1038, Public Power Risk Management Act of 2013

I

113TH CONGRESS
1ST SESSION

H. R. 1038

To provide equal treatment for utility special entities using utility operations-related swaps, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 11, 2013

Mr. LAMALFA (for himself, Mr. DENHAM, Mr. LUETKEMEYER, Mr. COSTA, and Mr. GARAMENDI) introduced the following bill; which was referred to the Committee on Agriculture

A BILL

To provide equal treatment for utility special entities using utility operations-related swaps, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Public Power Risk Management Act of 2013".

SEC. 2. TRANSACTIONS WITH UTILITY SPECIAL ENTITIES.

Section 1a(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)) is amended by adding at the end the following:

"(E) CERTAIN TRANSACTIONS WITH A UTILITY SPECIAL ENTITY.—

"(i) Transactions in utility operations-related swaps shall be reported pursuant to section 4r.

"(ii) In making a determination to exempt pursuant to subparagraph (D), the Commission shall treat a utility operations-related swap entered into with a utility special entity, as defined in section 4s(h)(2)(D), as if it were entered into with an entity that is not a special entity, as defined in section 4s(h)(2)(C).".

SEC. 3. UTILITY SPECIAL ENTITY DEFINED.

Section 4s(h)(2) of the Commodity Exchange Act (7 U.S.C. 6s(h)(2)) is amended by adding at the end the following:

"(D) UTILITY SPECIAL ENTITY.—For purposes of this Act, the term 'utility special entity' means a special entity, or any instrumentality, department, or corporation of or established by a State or political subdivision of a State, that—

"(i) owns or operates an electric or natural gas facility or an electric or natural gas operation;

"(ii) supplies natural gas and or electric energy to another utility special entity;

"(iii) has public service obligations under Federal, State, or local law or regulation to deliver electric energy or natural gas service to customers; or

"(iv) is a Federal power marketing agency, as defined in section 3 of the Federal Power Act.".

SEC. 4. UTILITY OPERATIONS-RELATED SWAP.

(a) SWAP FURTHER DEFINED.—Section 1a(47)(A)(iii) of the Commodity Exchange Act (7 U.S.C. 1a(47)(A)(iii)) is amended—

(1) by striking "and" at the end of subclause (XXI);

(2) by adding "and" at the end of subclause (XXII); and

(3) by adding at the end the following:

"(XXIII) a utility operations-related swap;".

(b) UTILITY OPERATIONS-RELATED SWAP DEFINED.—Section 1a of such Act (7 U.S.C. 1a) is amended by adding at the end the following:

"(52) UTILITY OPERATIONS-RELATED SWAP.—The term 'utility operations-related swap' means a swap that—

"(A) is entered into to hedge or mitigate a commercial risk;

"(B) is not a contract, agreement, or transaction based on, derived on, or referencing—

"(i) an interest rate, credit, equity, or currency asset class; or

"(ii) a metal, agricultural commodity, or crude oil or gasoline commodity of any grade, except as used as fuel for electric energy generation; and

"(C) is associated with—

"(i) the generation, production, purchase, or sale of natural gas or electric energy, the supply of natural gas or electric energy to a utility, or the delivery of natural gas or electric energy service to utility customers;

"(ii) all fuel supply for the facilities or operations of a utility;

"(iii) compliance with an electric system reliability obligation;

"(iv) compliance with an energy, energy efficiency, conservation, or renewable energy or environmental statute, regulation, or government order applicable to a utility; or

"(v) any other electric energy or natural gas swap to which a utility is a party.".

SEC. 5. EFFECTIVE DATE.

The amendments made by this Act take effect as if enacted on July 21, 2010.

○

[Discussion Draft] H.R. ____, Swap Jurisdiction Certainty Act*

[DISCUSSION DRAFT]

MARCH 12, 2013

113TH CONGRESS
1ST SESSION

H. R. ______

To direct the Securities and Exchange Commission and the Commodity Futures Trading Commission to jointly adopt rules setting forth the application to cross-border swaps transactions of certain provisions relating to swaps that were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act .

IN THE HOUSE OF REPRESENTATIVES

__________________ introduced the following bill; which was referred to the Committee on ____________________________

A BILL

To direct the Securities and Exchange Commission and the Commodity Futures Trading Commission to jointly adopt rules setting forth the application to cross-border swaps transactions of certain provisions relating to swaps that were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act .

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* **Editor's note:** The bill was introduced as H.R. 1256 on March 19, 2013.

SECTION 1. SHORT TITLE.

This Act may be cited as the ‘‘Swap Jurisdiction Certainty Act’’.

SEC. 2. JOINT RULEMAKING ON CROSS-BORDER SWAPS.

(a) IN GENERAL.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission and the Commodity Futures Trading Commission shall jointly issue rules setting forth the application of United States swaps requirements of the Securities Exchange Act of 1934 and the Commodity Exchange Act relating to swaps transacted between U.S. persons and non-U.S. persons.

(b) CONSIDERATIONS.—The Commissions shall issue rules that address—

(1) the nature of the connections to the United States that require a non-U.S. person to register as a swap dealer or major swap participant under each Commission's respective Acts and the regulations issued under such Acts;

(2) which of the United States swaps requirements shall apply to the swap activities of non-U.S. persons, U.S. persons, and their branches, agencies, subsidiaries, and affiliates outside of the United States and the extent to which such requirements shall apply; and

(3) the circumstances under which a non-U.S. person in compliance with the regulatory requirements of a foreign jurisdiction shall be exempt from United States swaps requirements.

(c) RULE IN ACCORDANCE WITH APA REQUIRED.—No guidance, memorandum of understanding, or any such other agreement may satisfy the requirement to issue a formal joint rule from the Commissions in accordance with section 553 of title 5, United States Code.

(d) GENERAL APPLICATION TO G20 MEMBER NATIONS.—

(1) GENERAL APPLICATION.—In issuing rules under subsection (b), the Commissions shall provide that a non-U.S. person in compliance with the regulatory requirements of a G20 member nation, or other foreign jurisdiction as jointly determined by the Commissions, shall be exempt from United States swaps requirements, unless the Commissions jointly determine that the regulatory requirements of the G20 member nation or other foreign jurisdiction are not broadly equivalent to United States swaps requirements.

(2) CRITERIA.—In such rules, the Commissions shall jointly establish criteria for determining that the regulatory requirements of a G20 member na-

tion or other foreign jurisdiction are not broadly equivalent to United States swaps requirements and shall jointly determine the appropriate application of certain United States swap requirements to that foreign jurisdiction or G20 nation.

(e) REPORT TO CONGRESS.—If the Commissions make the joint determination described in subsection (d)(1) that the regulatory requirements of the G20 member nation or other foreign jurisdiction are not broadly equivalent to United States swaps requirements, the Commissions shall articulate the basis for such a determination in a written report transmitted to the Committee on Financial Services and the Committee on Agriculture of the House of Representatives and the Committee on Banking and the Committee on Agriculture of the Senate within 30 days of the determination. The determination shall not be effective until the transmission of such report.

(f) DEFINITIONS.—As used in this Act and for purposes of the rules issued pursuant to this Act—

(1) the term ''G20 member nation'' refers to a nation that is a member nation of the Group of Twenty Finance Ministers and Central Bank Governors;

(2) the term ''U.S. person'' has the meaning given such term in section 230.902(k) of title 17,

Code of Federal Regulations, and the term "non-U.S. person" refers to any person excluded from the definition of U.S. person in such section; and

(3) the term "United States swaps requirements" means the provisions relating to swaps and security-based swaps contained in the Commodity Exchange Act (7 U.S.C. 1a et seq.) and the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) that were added by title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 8301 et seq.) and any rules or regulations prescribed by the Securities and Exchange Commission and the Commodity Futures Trading Commission pursuant to such provisions.

The CHAIRMAN. I now turn to the Ranking Member to make his opening statement.

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

Mr. PETERSON. Thank you, Mr. Chairman, and I want to welcome CFTC Chairman Gensler back to the Committee for what I have been told is his 50th appearance before Congressional committees going all the way back to his confirmation hearing, so I think that must be some kind of a record. So we appreciate your endurance.

For his first 2 years in office Chairman Gensler was helping us fix the financial mess left over from years of deregulation and lax oversight, and during the past 2 years he has been called to account for the Commission's implementation of Dodd-Frank reforms enacted in 2010.

Last Congress this Committee held several hearings as the Chairman has indicated where we listened to a host of stakeholders express concerns about Dodd-Frank's implementation. At each of these hearings I repeatedly recommended patience and caution for those seeking to change the law, and I think that patience generally has been rewarded with the Commission producing thoughtful final rules that respond to the concerns that were being raised.

Today's hearing is to examine legislative proposals seeking to address many of those same concerns, and I, again, recommend patience. Despite the bipartisan support that some of these bills may have, I just don't see how any of these have any chance of passing the Senate.

Additionally, given the CFTC's performance, I still believe that much of the legislation we are discussing today will not be needed in the end. The CFTC is most likely going to get this right, and today many of the final rules coming out of the Commission have broad bipartisan support and are addressing the concerns that stakeholders have expressed to both us and to the Commission.

Ironically, the issue that may truly need to be addressed, margin requirements on end-users, is a problem not being caused by the CFTC but by the proposed rule of the Prudential Regulators. In my opinion we should be bringing the Prudential Regulators in to answer questions about their proposed rule, because we aren't holding them accountable for their actions. I raised this same issue in the previous Congress when we held a hearing on the predecessor, H.R. 634, and we still haven't heard from them.

Sometime this summer the CFTC will complete the vast majority of its rulemaking. To me that is the best time to see what has been done, see the whole picture, and at that point fix what needs to be fixed, and hopefully by that time we will have completed our work in the House on the farm bill, and then we can turn our attention to the CFTC reauthorization, which I believe is the best chance for enacting any improvements to Dodd-Frank, if necessary.

So with that, Mr. Chairman, I appreciate the time and yield back.

[The prepared statement of Mr. Peterson follows:]

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

Thank you, Mr. Chairman. I want to welcome CFTC Chairman Gensler for what I have been told is his 50th appearance before a Congressional Committee, going all the way back to his confirmation hearing. That has to be some kind of record.

For his first 2 years in office, Chairman Gensler was helping us fix the financial mess left over from years of deregulation and lax oversight. During the past 2 years, he has been called to account for the Commission's implementation of the Dodd-Frank reforms Congress enacted in 2010.

Last Congress, this Committee held several hearings where we listened to a host of stakeholders express concerns about Dodd-Frank's implementation. At each of these hearings, I repeatedly recommended patience and caution for those seeking to change the law. I believe that patience has generally been rewarded, with the Commission producing thoughtful, final rules that respond to the concerns being raised.

Today's hearing is to examine legislative proposals seeking to address many of those same concerns and I, again, recommend patience.

Despite the bipartisan support that some of these bills may have, I just don't see how they have any chance passing the Senate.

Additionally, given the CFTC's performance, I still believe that much of the legislation we're discussing today will not be needed. The CFTC is going to get this right. To date, many of the final rules coming out of the Commission have broad bipartisan support and are addressing the concerns that stakeholders have expressed to both us and the Commission.

Ironically, the issue that may truly need to be addressed—margin requirements on end-users—is a problem not being caused by the CFTC, but by the proposed rule of the Prudential Regulators.

We really should be bringing the Prudential Regulators in to answer questions about their proposed rule because we aren't holding them accountable for their actions. I raised this same issue in previous Congress when we held a hearing on the predecessor to H.R. 634.

Sometime this summer, the CFTC will complete the vast majority of its rulemaking. To me, that is the best time to see what has been done and fix what needs to be fixed. Hopefully, we will have completed our work in the House on the farm bill and can turn our attention to CFTC reauthorization, which I believe is the best chance for enacting any improvements to Dodd-Frank, if necessary.

With that Mr. Chairman, I appreciate the time and I yield back.

The CHAIRMAN. I thank the gentleman for his comments.

The chair requests that other Members submit their opening statements for the record so that the witnesses may begin their testimony and to ensure there is ample time for questions.

[The prepared statement of Mr. Conaway and Ms. Fudge follow:]

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

Mr. Chairman, thank you for convening this hearing and offering our Committee another opportunity to examine the Dodd-Frank Act, its implementation, and potential fixes to some of the legislative oversights in the bill.

I don't think anyone in this room would say that we got Dodd-Frank exactly right, so it is important that we take time at hearings like this to see what sections need to be corrected, what exemptions need to be broadened, and what instructions to the Commission need to be made more clear. Six of the bills we will examine today make exactly these type of narrow, focused changes to the law. In fact, because our Committee is focused on narrow fixes to the law, and not wholesale repeal, all of the bills we are examining today have bipartisan support. I am grateful to my Democratic colleagues for working with us on these issues.

One issue that has been particularly unclear over the past several years has been the extra-territorial application of the Dodd-Frank Act. How laws flow across jurisdictional boundaries has a profound impact on how businesses operate. Last December, Members of this Committee heard testimony from several foreign regulators who expressed grave concerns about the CFTC's approach to these cross-border issues. I am worried that if the CFTC continues to go its own way, financial firms will exit American markets, reducing liquidity and increasing costs for end-users and other market participants.

I am pleased that our Committee will consider the Swap Jurisdiction Certainty Act which would require the CFTC to cooperate with the SEC on promulgating a rule on the cross-border application of the Dodd-Frank rules, as well as to recognize the competence of foreign regulators. I am deeply concerned that the current course the CFTC is pursuing will have substantial economic burdens for little regulatory benefits.

This is not the first rulemaking that I have had concerns about the appropriate accounting of the costs and benefits. Throughout the entire process of implementing Dodd-Frank, I have asked Chairman Gensler repeatedly to step up the standards of economic analysis for the rules the CFTC is proposing.

In his defense, Chairman Gensler has said that the Commission is complying with the law, which only requires that the CFTC "consider" the costs and benefits of a particular rulemaking. The Inspector General of the CFTC has said this has lead to a "check-the-box" approach to cost-benefit analysis, where the actual analysis is often performed by the lawyers instead of economists.

That is why I am again offering a bill, along with the support of Ranking Member Scott, Congressman Vargas, and others, that would set new standards for the economic analysis that the CFTC must perform on each new rulemaking. I believe that the Executive Order laid out by President Obama on cost-benefit analysis should represent the standard to which agencies are held, and the bill we are discussing today would do just that.

One final issue that I am concerned about is the breaches of data confidentiality that have been seen in the Commission in recent months. The CFTC is privy to a wealth of proprietary information regarding the trades, positions, and strategies of every market participant. It relies on this data to be an effective regulator, but the recent reports that proprietary data has been made public calls into question the strength of the Commission's internal controls on the data it collects.

As a recent *Washington Post* Op-Ed co-written by former CFTC Chairman James Newsome and former Commissioner Fred Hatfield states clearly, "If [market] participants believe others have a likelihood of re-creating trading strategies or identifying their derivatives positions from leaked data, they will work to avoid sharing data with regulators. Doing so would be a tremendous blow to regulators and a critical setback for industry participants who want to operate in markets free from fraud, manipulation and other abuses."

It is imperative for the Commission to instill trust and confidence in market participants. The CFTC cannot do so if the confidential data market participants provide the Commission makes its way into the public eye.

I look forward to the opportunity to discuss our proposed legislation with Chairman Gensler and the rest of our witnesses. As I have said many times, it is more important that we get Dodd-Frank reform right than that we get it done quickly. Today's bills will help ensure that we get Dodd-Frank right.

PREPARED STATEMENT OF HON. MARCIA L. FUDGE, A REPRESENTATIVE IN CONGRESS FROM OHIO

Thank you for convening this hearing. Recently, I and Representatives Stivers, Moore, and Gibson introduced H.R. 677, the Inter-Affiliate Swap Clarification Act. H.R. 677 makes plain that inter-affiliate transactions, when the parties to the transaction are under common control or use centralized hedging units to manage risk efficiently, should not be regulated as swaps. Last Congress, my colleagues and I introduced similar legislation that eventually passed the House by a vote of 357–36. Given the broad consensus and bipartisan support this issue received last year, I'm hopeful that H.R. 677 will be widely supported as well.

I appreciate having the opportunity to hear from experts in the field on why clarification on the regulations for inter-affiliate swaps is needed.

The CHAIRMAN. I would like to welcome our first panel witness today, the Hon. Gary Gensler, Chairman of the U.S. Commodity Futures Trading Commission, Washington, D.C. Chairman Gensler, please begin when you are ready.

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

Mr. GENSLER. Chairman Lucas, Ranking Member Peterson, Members of this Committee, it is always good to be with you. I appreciate that note about 50 hearings in this job, but I think I have also been told it is my 10th before you, and I always enjoy being here and the advice and counsel that you give us, whether it is in the rule writing or everyday business of the Commission.

Five years ago tomorrow Bear Stearns failed. You might remember this was a large financial institution in New York. The Federal Reserve and others arranged its quick sale to JPMorgan, but that was really the beginning of what we now call the 2008 Financial Crisis. Those next 6 months, or next year, put so many people at risk in the American economy and eight million people lost their jobs.

In response, this Committee was the first to address derivatives reform early in 2009, when you passed a bill and then working later with the House Financial Services passed what was the core of what became Title VII, and most of that is now in place.

So what does this mean? For the first time the public is actually benefitting from seeing the price and volume of each swap transaction. It is available free of charge on a website. I see the members from DTCC are here. They can tell you about the website. It is free of charge like a modern-day tickertape where people can see the price and volume of swaps transactions.

For the first time the public also benefits from greater access to the markets with the risk reduction of central clearing. This week on Monday mandatory clearing for these big dealers took hold. That means that there is lower risk, and the system is a little less interconnected.

And for the first time the public is benefiting from the oversight of the dealers themselves. We now have 73 that are registered. It was at the center of your hearing that you had with the international regulators in December. We did move forward, exempting many of the things that they need to do until this coming July to try to get it right and focus on something called substituted compliance.

This reform was not about preventing firms from failing, though. Just as Bear Stearns failed 5 years ago, certainly some firms will fail in the future. I think that this part of the bill is about making the system safer because it is less interconnected, that it is less likely that taxpayers will have to come in and help out or bail out a firm as we all did in AIG, but I think it is also so that the end-users get a more transparent market and more access to the market.

It is about those firms that employ 94 percent of private-sector jobs. That is what end-users are: the non-financial firms that employ 94 percent of jobs in this economy, and the reforms were about giving end-users a choice. They don't have to come into clearing and by the CFTC rules, as the Ranking Member mentioned, they would not be caught up in margining for the non-cleared swaps.

Now, we do have key things in front of us. In 2013, we still need to finish up some pieces of this business. We are still promoting further transparency before the transaction. It is called pre-trade transparency. Due to that we have in front of us finishing rules on what is called swap execution facilities.

Second, a big part of it is the cross-border application as the Chairman mentioned of the swaps market reform. Congress recognized in enacting reform is that in modern finance many of these institutions span the globe, and risk knows no boundary. If a run starts in one part of a financial institution, it runs right back here. That is what happened at Bear Stearns, of course, but also it was true of AIG, which ran most of its swaps business out of London. It was true of Lehman Brothers, it was true a decade earlier in something called Long-Term Capital Management. The company, LTCM, was run in Connecticut but booked their $1.2 trillion of derivatives in the Cayman Islands.

Failing to incorporate the basic lesson of modern finance would leave the American public at risk. It would move maybe the jobs to the Cayman Islands or the P.O. Boxes on the Cayman Islands or the jobs somewhere else, but the risk would spill right back here if it is a U.S. financial institution. So, I think we have to address that, and we are trying to do that by July of this year.

We also have in front of us an important and tough agenda around the London Interbank Offered Rate. It is not the center of this hearing, but I am glad to take any questions on that. I think long term, though, we are going to find that that rate—that has been so pervasively and readily rigged—is not sustainable in our financial markets.

I would like to just close by mentioning the need for resources. The CFTC today is a little smaller than we were 1 year ago, and yet now the swaps reform is upon us. I think that we are not right sized for the critical missions that you have given us. The Congress has given us responsibility for the futures markets as well as the swaps market so that the end-users of this country can have confidence that these markets are well-overseen and don't present risk to them.

So I thank you, and I look forward to questions.

[The prepared statement of Mr. Gensler follows:]

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

Good morning, Chairman Lucas, Ranking Member Peterson, and Members of the Committee. I thank you for inviting me to testify on the status of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) Title VII implementation. I also want to thank the Commodity Futures Trading Commission's (CFTC) Commissioners and staff for their hard work and dedication.

Introduction

I am pleased to have the opportunity to discuss with you the CFTC's efforts on behalf of the public. The agency has been directed by Congress to oversee and police the nation's derivatives markets, both in the futures and swaps markets. It strives to promote transparency, fairness and integrity in these markets. The CFTC continues to carry out its historical mission regarding the rapidly changing futures market, while developing and integrating comprehensive standards for the swaps market. The Commission has reorganized its divisions to best ensure ongoing oversight of the futures market, as well as the swaps markets. We also have implemented improvements in protections for customer funds and are developing others. We continue to engage in targeted enforcement efforts in the public interest. These include the historic actions regarding benchmark rates, such as the London Interbank Offered Rate (LIBOR), a reference rate for much of the U.S. futures and swaps markets.

The New Era of Swaps Market Reform

Congress made history with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and the CFTC now oversees the entire derivatives marketplace—across both futures and swaps. The common-sense rules of the road for the swaps market that Congress included in the law have taken shape and market participants are adapting to them.

For the first time, the public is benefiting from seeing the price and volume of each swap transaction. This post-trade transparency builds upon what has worked for decades in the futures and securities markets. The new swaps market information is available free of charge on a website, like a modern-day ticker tape.

For the first time, the public will benefit from the greater access to the markets and the risk reduction that comes with central clearing. Required clearing of interest rate and credit index swaps between financial entities began this week.

For the first time, the public is benefitting from specific oversight of swap dealers. More than 70 swap dealers have provisionally registered. They are subject to standards for sales practices, record-keeping and business conduct to help lower risk to the economy and protect the public from fraud and manipulation.

An earlier economic crisis led President Roosevelt and Congress to enact similar common-sense rules of the road for the futures and securities markets. I believe these critical reforms of the 1930s have been at the foundation of our strong capital markets and many decades of economic growth.

In the 1980s, the swaps market emerged. Until now, though, it has lacked the benefit of rules to promote transparency, lower risk and protect the public, rules that we have come to depend upon in the futures and securities markets. What followed was the 2008 Financial Crisis—a crisis that was due in part to the swaps market. Eight million American jobs were lost. In contrast, the futures market, supported by earlier reforms, weathered the financial crisis.

Congress and the President responded to the worst economic crisis since the Great Depression and carefully crafted the Dodd-Frank swaps provisions. They borrowed from what has worked best in the futures market for decades: transparency, clearing and oversight of intermediaries.

The CFTC has largely completed swaps market rule-writing, with 80 percent behind us. On October 12, the CFTC and Securities and Exchange Commission's (SEC) foundational definition rules went into effect. This marked the new era of swaps market reform.

The CFTC is seeking to consider and finalize the remaining Dodd-Frank Act swaps reforms this year. In addition, as Congress directed the CFTC to do, I believe it is critical that we continue our efforts to put in place aggregate speculative position limits across futures and swaps on physical commodities.

The agency has completed each of these Congressionally-directed reforms with an eye toward ensuring that the swaps market works for end-users, America's primary job providers. It's the end-users in the non-financial side of our economy that provide 94 percent of private sector jobs.

Dodd-Frank Act swaps market reforms benefit end-users by lowering costs and increasing access to the markets. They benefit end-users through greater transparency—shifting information from Wall Street to Main Street. Following Congress' direction, end-users are not required to bring swaps into central clearing. Further, the Commission's proposed rule on margin provides that end-users will not have to post margin for uncleared swaps. Also, non-financial companies, other than those genuinely making markets in swaps, will not be required to register as swap dealers. Lastly, when end-users are required to report their transactions, they are given more time to do so than other market participants.

Congress also authorized the CFTC to provide relief from the Dodd-Frank Act's swaps reforms for certain electricity and electricity-related energy transactions between rural electric cooperatives and Federal, state, municipal and tribal power authorities. Similarly, Congress authorized the CFTC to provide relief for certain transactions on markets administered by regional transmission organizations and independent system operators. The CFTC is looking to soon finalize exemptive orders related to these transactions, as Congress authorized.

The CFTC has worked to complete the Dodd-Frank reforms in a deliberative way—not against a clock. We have been careful to consider public input, as well as the costs and benefits of each rule. CFTC Commissioners and staff have met more than 2,000 times with members of the public, and we have held 23 public roundtables. The agency has received more than 39,000 comment letters on matters related to reform. The rules also have benefited from close consultation with domestic and international regulators and policymakers.

Throughout this process, the Commission has sought input from market participants on appropriate schedules to phase in compliance with swaps reforms. Now, over 2½ years since the Dodd-Frank Act passed and with 80 percent of our rules finalized, the market is moving to implementation. Thus, it's the natural order of things that market participants have questions and have come to us for further guidance. The CFTC welcomes inquiries from market participants, as some fine-tuning is expected. As it is sometimes the case with human nature, the agency receives many inquiries as compliance deadlines approach.

My fellow Commissioners and I, along with CFTC staff, have listened to market participants and thoughtfully sorted through issues as they were brought to our attention, and we will continue to do so.

I now will go into further detail on the Commission's efforts to implement the Dodd-Frank Act's swaps market reform, our efforts to enhance protections for futures and swaps customers, and the CFTC's work with international regulators regarding benchmarks.

Transparency—Lowering Cost and Increasing Liquidity, Efficiency, Competition

Transparency—a longstanding hallmark of the futures market, both pre- and post-trade—lowers costs for investors, consumers and businesses. It increases liquidity, efficiency and competition. A key benefit of swaps reform is providing this critical pricing information to businesses and other end-users across this land that use the swaps market to lock in a price or hedge a risk.

As of December 31, 2012, provisionally registered swap dealers are reporting in real time their interest rate and credit index swap transactions to the public and to regulators through swap data repositories. These are some of the same products that were at the center of the financial crisis. Building on this, swap dealers began reporting swap transactions in equity, foreign exchange and other commodity asset classes on February 28. Other market participants will begin reporting April 10.

With these transparency reforms, the public and regulators now have their first full window into the swaps marketplace.

To further enhance liquidity and price competition, the CFTC is working to finish the pre-trade transparency rules for swap execution facilities (SEFs), as well as the block rule for swaps. SEFs would allow market participants to view the prices of available bids and offers prior to making their decision on a transaction. These rules will build on the democratization of the swaps market that comes with the clearing of standardized swaps.

Clearing—Lowering Risk and Democratizing the Market

Since the late 19th century, clearinghouses have lowered risk for the public and fostered competition in the futures market. Clearing also has democratized the market by fostering access for farmers, ranchers, merchants and other participants.

The Commission approved the first clearing requirement last November, following through on the U.S. commitment at the 2009 G20 meeting that standardized swaps be cleared by the end of 2012. A key milestone was reached this week with the requirement that swap dealers and the largest hedge funds clear as of March 11. The vast majority of interest rate and credit default index swaps are being brought into central clearing. Compliance will continue to be phased in throughout this year. Other financial entities begin clearing June 10. Accounts managed by third party investment managers and ERISA pension plans have until September 9.

Consistent with the direction of Dodd-Frank, the Commission in the fall of 2011 adopted a comprehensive set of rules for the risk management of clearinghouses. These final rules were consistent with international standards, as evidenced by the Principles for Financial Market Infrastructures (PFMIs) consultative document that had been published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS–IOSCO).

In April of 2012, CPSS–IOSCO issued the final Principles. The Commission's clearinghouse risk management rules cover the vast majority of those standards. Commission staff are working expeditiously to recommend the necessary steps so that the Commission may implement any remaining items from the PFMIs not yet incorporated in our clearinghouse rules. I look forward to the Commission considering action on this in 2013.

I expect that soon we will complete a rule to exempt swaps between certain affiliated entities within a corporate group from the clearing requirement. This year, the CFTC also will be considering possible clearing determinations for other commodity swaps, including energy swaps.

Swap Dealer Oversight—Promoting Market Integrity and Lowering Risk

Comprehensive oversight of swap dealers, a foundational piece of the Dodd-Frank Act, will promote market integrity and lower risk to taxpayers and the rest of the economy. Congress directed that end-users be able to continue benefitting from customized swaps (those not brought into central clearing) while being protected through the express oversight of swap dealers. In addition, Dodd-Frank extended the CFTC's existing oversight of previously regulated intermediaries to include their swaps activity.

As the result of CFTC rules completed in the first half of last year, 73 swap dealers are now provisionally registered. This initial group of dealers includes the largest domestic and international financial institutions dealing in swaps with U.S. persons. It includes the 16 institutions commonly referred to as the G16 dealers. Two major swap participants also are registered. Other entities will register once they reach the *de minimis* threshold for swap activity.

In addition to reporting trades to both regulators and the public, swap dealers will implement crucial back office standards that lower risk and increase market integrity. These include promoting the timely confirmation of trades and documentation of the trading relationship. Swap dealers also will be required to implement sales practice standards that prohibit fraud, require fair treatment of customers and improve transparency.

The CFTC is collaborating closely domestically and internationally on a global approach to margin requirements for uncleared swaps. We are working along with the Federal Reserve, the other U.S. banking regulators, the SEC and our international counterparts on a final set of standards to be published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO). The CFTC's proposed margin rules excluded non-financial end-users from margin requirements for uncleared swaps. We have been advocating with global regulators for an approach consistent with that of the CFTC. I would anticipate that the CFTC, in consultation with European regulators, would take up final margin rules, as well as related rules on capital, in the second half of this year.

Following Congress' mandate, the CFTC also is working with our fellow domestic financial regulators to complete the Volcker Rule. In adopting the Volcker Rule, Congress prohibited banking entities from proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in certain activities, such as market making and risk mitigating hedging. One of the challenges in finalizing a rule is achieving these multiple objectives.

International Coordination on Swaps Market Reform

In enacting financial reform, Congress recognized a basic lesson of modern finance and the 2008 crisis: during a default, risk knows no geographic border.

Risk from our housing and financial crisis contributed to economic downturns around the globe. If a run starts in one part of a modern financial institution, whether it's here or offshore, the risk comes back to our shores. It was true with AIG, Lehman Brothers, Citigroup, Bear Stearns and Long-Term Capital Management.

AIG Financial Products, for instance, was a Connecticut subsidiary of the New York insurance giant that used a French bank license to run its swaps operations out of a Mayfair branch in London. Its near-collapse ultimately required a government bailout of more than $180 billion and nearly brought down the U.S. economy.

Last year's events of JPMorgan Chase, where it executed swaps through its London branch, were a stark reminder of how when risk is booked offshore, any losses are absorbed back here at home.

Congress addressed this reality of modern finance in Section 722(d) of the Dodd-Frank Act, which states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States."

To give financial institutions and market participants guidance on this provision, the CFTC last June sought public consultation on its interpretation of this provision. The proposed guidance is a balanced, measured approach, consistent with the cross-border provisions in the Dodd-Frank Act and the recognition that risk easily crosses borders.

As the CFTC completes the cross-border guidance, I believe it's critical that Dodd-Frank swaps reform applies to transactions entered into by branches of U.S. institutions offshore, between guaranteed affiliates offshore, and for hedge funds that are incorporated offshore but operate in the U.S. Otherwise, American jobs and markets may move offshore, but, particularly in times of crisis, risk would come crashing back to our economy.

The proposed guidance includes a commitment to permitting foreign firms and, in certain circumstances, overseas branches and guaranteed affiliates of U.S. swap dealers, to meet Dodd-Frank requirements through compliance with comparable and comprehensive foreign rules. We call this "substituted compliance."

The Commission also proposed granting time-limited relief until this July for non-U.S. swap dealers (and foreign branches of U.S. swap dealers) from certain Dodd-Frank swap requirements. In December, the Commission finalized this relief.

Under this time-limited relief, foreign swap dealers may phase in compliance with certain entity-level requirements. In addition, it provides relief for foreign dealers from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers.

In July, when the relief expires, various Dodd-Frank Act requirements will apply to non-U.S. swap dealers. Overseas financial institutions who wish to look to substituted compliance to fulfill Dodd-Frank requirements are encouraged to engage now with the CFTC, as well as their home country regulators.

We are hearing that some swap dealers may be promoting to hedge funds an idea to avoid required clearing, at least during an interim period from March until July. I would be concerned if, in an effort to avoid clearing, swap dealers route to their foreign affiliates trades with hedge funds organized offshore, even though such hedge funds are managed (or otherwise have their principal place of business) in the United States or they are majority owned by U.S. persons. Such an effort is not consistent with the spirit of the Dodd-Frank Act or the international consensus to clear all standardized swaps. The CFTC is working to ensure that this idea does not prevail and develop into a practice that leaves the American public at risk.

If we don't address this, the P.O. boxes may be offshore, but the risk will flow back here.

Customer Protection

The Dodd-Frank Act included provisions directing the CFTC to enhance the protection of swaps customer funds. While it was not a requirement of the Dodd-Frank Act, in 2009 the CFTC also reviewed and updated customer protection rules for futures market customers. As a result, a number of the enhancements affect both futures and swaps market customers. I would like to review these enhancements, as well as an important customer protection proposal.

The CFTC's completed amendments to rule 1.25 regarding the investment of customer funds benefit both futures and swaps customers. The amendments include preventing in-house lending of customer money through repurchase agreements. The CFTC's gross margining rules for futures and swaps customers require clearinghouses to collect margin on a gross basis. FCMs are no longer able to offset one customer's collateral against another or to send only the net to the clearinghouse.

Swaps customers further benefit from the new so-called "LSOC" (legal segregation with operational comingling) rules, which ensure funds are protected individually all the way to the clearinghouse.

The Commission also worked closely with market participants on new customer protection rules adopted by the self-regulatory organization (SRO), the National Futures Association (NFA). These include requiring FCMs to hold sufficient funds for U.S. foreign futures and options customers trading on foreign contract markets (in Part 30 secured accounts). Starting last year, they must meet their total obligations to customers trading on foreign markets under the net liquidating equity method. In addition, withdrawals of 25 percent or more of excess segregated funds would necessitate pre-approval in writing by senior management and must be reported to the designated SRO and the CFTC.

These steps were significant, but market events have further highlighted that the Commission must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds.

In the fall of 2012, the Commission sought public comment on a proposal that would strengthen the controls around customer funds at FCMs. It would set new regulatory accounting requirements and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to the FCMs' bank and custodial accounts for customer funds.

The proposal includes a provision on residual interest to ensure that the assets of one customer are not used to cover the positions of another customer. We are considering the many comments we have received on this and plan to finalize the proposal consistent with the specific provisions of the Commodity Exchange Act and the overall goal of protecting customers.

Further, the CFTC intends to finalize a rule this year on segregation for uncleared swaps.

Benchmark Interest Rates

This hearing comes at a critical juncture.

It comes as there has been a lot of media attention surrounding the three enforcement cases against Barclays, UBS and RBS for manipulative conduct with respect to the London Interbank Offered Rate (LIBOR) and other benchmark interest rate submissions.

More importantly, it comes as market participants and regulators around the globe have turned to consider the critical issue of how we reform and revise a system that has become so reliant on LIBOR, Euribor and similar rates.

I believe that continuing to reference such rates diminishes market integrity and is unsustainable in the long run.

Let's look at what we've learned to date.

Foremost, the Interbank, unsecured market to which LIBOR, Euribor and other such rates reference has changed dramatically. Some say that it is has become essentially nonexistent. In 2008, Mervyn King, the governor of the Bank of England, said of LIBOR: "It is, in many ways, the rate at which banks do not lend to each other." He went on further to say: "[I]t is not a rate at which anyone is actually borrowing."

There has been a significant structural shift in how financial market participants finance their balance sheets and trading positions. There is an increasing shift from borrowing unsecured (without posting collateral) toward borrowings that are secured by posting collateral. In particular, this shift has occurred within the funding markets between banks.

The Interbank, unsecured market used to be where banks funded themselves at a wholesale rate. The 2008 Financial Crisis and subsequent events, however, have shattered this model. The European debt crisis that began in 2010 and the downgrading of large banks' credit ratings have exacerbated the hesitancy of banks to lend unsecured to one another.

Other factors have played a role in this structural shift. Central banks are providing significant funding directly to banks. Banks are more closely managing demands on their balance sheets.

Looking forward, recent changes to Basel capital rules will take root and will move banks even further from interbank lending. The Basel III capital rules now include an asset correlation factor, which requires additional capital when a bank is exposed to another bank. This was included to reduce financial system interconnectedness. Furthermore, the rules introduce a liquidity coverage ratio (LCR). For the first time, banks will have to hold a sufficient amount of high quality liquid assets to cover their projected net outflows over 30 days.

At an IOSCO roundtable on financial market benchmarks held in London last month, one major bank indicated that the LCR rule alone would make it prohibitively expensive for banks to lend to each other in the interbank market for tenors greater than 30 days. Thus, this banker posited that it is unlikely that banks will return to the days when they would lend to each other for 3 months, 6 months or a year.

The public also has learned that LIBOR and Euribor—central to borrowing, lending and hedging in our economies—has been readily and pervasively rigged.

Barclays, UBS and RBS were fined approximately $2.5 billion for manipulative conduct by the CFTC, the UK Financial Services Authority (FSA) and the U.S. Justice Department. At each bank, the misconduct spanned many years; took place in offices in several cities around the globe; included numerous people—sometimes dozens, and even senior management; and involved multiple benchmark rates and currencies. In each case, there was evidence of collusion.

In the UBS and RBS cases, one or more inter-dealer brokers painted false pictures to influence submissions of other banks, *i.e.,* to spread the falsehoods more widely. Barclays and UBS also were reporting falsely low borrowing rates in an effort to protect their reputation.

These findings are shocking, though the lack of an interbank market made the system more vulnerable to such misconduct.

In addition, a significant amount of publicly available market data raises questions about the integrity of LIBOR and similar rates today.

A comparison of LIBOR submissions to the volatilities of other short-term rates reflects that LIBOR is remarkably more stable than any comparable rate. For instance, in 2012—looking at the 252 submission days for 3 month U.S. dollar LIBOR—the banks did not change their rate 85 percent of the time. Some banks did not change their submissions for 3 month U.S. Dollar LIBOR for upwards of 115 straight trading days. This means, in effect, that one bank represented that the market for its funding was completely stable for 115 straight trading days or more than 5 months.

Further, when comparing LIBOR submissions to the same banks' credit default swaps spreads or to the broader markets' currency forward rates, there is a continuing disconnect between LIBOR and what those other market rates tell us.

Nassim Nicholas Taleb, the best selling author of *The Black Swan,* has written a recent book called *Antifragile: Things that Gain from Disorder.* He notes that systems that are not readily able to evolve and adapt are fragile. Such systems succumb to stress, tension and change. One of his key points is that propping up a fragile system in the interest of maintaining a sense of stability only creates more instability in the end. One can buy an artificial sense of calm for a while, but when that calm cracks, the resulting turmoil is invariably greater.

I think that the financial system's reliance on interest rate benchmarks, such as LIBOR and Euribor, is particularly fragile. These benchmarks basically have not adapted to the significant changes in the market. Thus, the challenge we face is how the financial system adapts to this significant shift.

International regulators and market participants have begun to discuss transition. The CFTC and the FSA are co-chairing the IOSCO Task Force on Financial Market Benchmarks.

One of the key questions in the consultation with the public is: how do we address transition when a benchmark is no longer tied to sufficient transactions and may have become unreliable or obsolete?

Without transactions, the situation is similar to trying to buy a house, when the realtor cannot provide comparable transaction prices in the neighborhood—because no houses were sold in the neighborhood in years.

Given what the public has learned, it is critical to move to a more robust framework for financial benchmarks, particularly those for short-term, variable interest rates. A reference rate has to be based on facts, not fiction.

I recognize that moving on from LIBOR and Euribor may be challenging. Today, LIBOR is the reference rate for 70 percent of the U.S. futures market, most of the swaps market and nearly half of U.S. adjustable rate mortgages.

Yet, as the author Nassim Taleb might suggest, it would be best not to fall prey to accepting that LIBOR or any benchmark is "too big to replace."

Resources

The CFTC's hardworking team of 684 is just seven percent more in numbers than at our peak in the 1990s. Yet since that time, the futures market has grown fivefold, and the swaps market is eight times larger than the futures market.

Investments in both technology and people are needed for effective oversight of these markets by regulators.

Though data has started to be reported to the public and to regulators, we need the staff and technology to access, review and analyze the data. Though 75 entities have registered as new swap dealers and major swap participants, we need people to answer their questions and work with the NFA on the necessary oversight to ensure market integrity. Furthermore, as market participants expand their technological sophistication, CFTC technology upgrades are critical for market surveillance and to enhance customer fund protection programs.

Without sufficient funding for the CFTC, the nation cannot be assured this agency can closely monitor for the protection of customer funds and utilize our enforcement arm to its fullest potential to go after bad actors in the futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that this agency can effectively enforce essential rules that promote transparency and lower risk to the economy.

The CFTC is currently funded at $207 million. To fulfill our mission for the benefit of the public, the President requested $308 million for Fiscal Year 2013 and 1,015 full-time employees.

Thank you again for inviting me today, and I look forward to your questions.

The CHAIRMAN. Thank you, Chairman Gensler.

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

And I recognize myself for 5 minutes now.

Chairman, top regulators from European Union and Japan testified before the Committee in December and detailed serious concerns about CFTC's cross-border guidance, stating that if cross-border rules weren't harmonized, trades will not be able to clear, if they can't be cleared, they won't take place, firms and users will not hedge the risk or firms will hedge the risk, but they will only take place within one jurisdiction. The consequences of that is obviously a fragmented market, significant concentration of financial risk in the U.S. system, and is exactly what we have tried to prevent with our global regulatory reforms.

Now, given multiple failed attempts to coordinate between the United States and international regulators, the most recently-failed negotiations occurring in February, and we are moving quickly towards that scenario described to us in December. Chairman, with all due respect, why don't you believe that long established markets will have sufficient regulatory regimes or overseas swap transactions within their own borders? Expand on that if you would.

Mr. GENSLER. We have made tremendous progress here in this country with the financial reform that this Committee helped put in place in Dodd-Frank, and there has been great progress in Europe, Canada, and Japan in terms of the central clearing, data reporting and some other means.

We have embraced and said that where there is comparable and comprehensive regimes in other countries, we would look to something we call substituted compliance. We could look to that home country's rules, but if a U.S. firm is guaranteeing activities of a London affiliate or a Cayman Islands affiliate or somewhere else, if they are guaranteeing that, that risk can still come back here to the U.S. So we said there has to at least be comparable and comprehensive oversight. Not every jurisdiction would have that. Many will. Many will.

The CHAIRMAN. Moving to another important subject, I have heard concerns from farmers, ranchers, the small to medium-sized futures commission merchants opposing CFTC's proposed rule to improve customer protections. Many of those folks say the new proposals would profoundly increase their costs, potentially threaten their existence, and this is very disturbing to me because many of these smaller FCMs are the ones who actually serve risk management needs of my farmers and ranchers, the two groups that are of the utmost importance to this Committee.

Putting aside your statutory requirements and given the importance of this subject, was there an extensive cost-benefit analysis performed by the Office of Chief Economist before those rules were proposed, Chairman?

Mr. GENSLER. Yes. We take seriously the cost-benefit provisions that were put in the statute over a dozen years ago, and the Chief Economist's Office participates and signs off on each of those before they come to the Commissioners. Rules are also put out for public comment. In this case we put out a set of proposals on customer protection to the public. Many of those proposals have gotten strong support. We received about 125 comment letters, but you are absolutely right, Mr. Chairman. There is one issue in there—people have been using the term *residual interest*—that has been raised where we are going to take a very thoughtful look at the comments that have come in because people have raised not only cost issues, but just some practicality issues with regard to it.

The CHAIRMAN. So along that line, given the outcry, does the Commission plan to re-propose the rule or make extensive changes to the rule?

Mr. GENSLER. I don't know yet, and I would like to keep this Committee and you apprised. The comment period only closed about 2 weeks ago. We extended it an extra month at the request of many market participants. At its core what we did was we repeated what is in the law. The law says that no futures commission merchant should take one customer's money and use it to benefit or secure, guarantee another customer's position, their deficit or their position.

And that is, in fact, what we said, but what we found is commenters have said that intraday, during the day they actually do sometimes have one customer's surplus guaranteeing other customer's deficits, and so we have to sort through that practical circumstance.

The CHAIRMAN. Just bear in mind, Commissioner, that the Committee won't ignore the pleas from the smaller ag players in the market, and I am hopeful the Commission won't either.

Returning to the cross-border issue, I understand the European officials could stretch the implementation timeline out into next year for their own derivatives rules, and earlier this week one of your Commissioners even stated or one of the Commissioners even stated it would not be unlikely for the CFTC to grant another extension to implement the cross-border guidance.

So I guess my question is if the European regulators extend their own rulemaking process into next year, and we made no progress on substituted compliance by July 2013, global markets would be in danger of, I think the appropriate phrase is fragmentation and pooling risks. How do you plan to avoid that outcome, Chairman?

Mr. GENSLER. We have been committed this whole time to phased implementation. You actually only gave us 1 year to get everything in place, and here we are nearly 3 years since Dodd-Frank passed. There were even bills considered at some point to ask us to take more time. We have not felt we are doing this against the clock. We want to get it balanced and appropriately in place, but I also think we keep in mind that 5 years ago Bear Stearns failed, and eight million people lost their jobs.

So I would envision as we get closer to July we will have checked off more things with the Europeans and Canadians and others, like Japan. We now have 30 international dealers regulated and registered, which is a big positive. We have the public seeing their transactions for the first time, which is a big positive, and we will see where we are as we approach July as to whether there is some appropriate additional phased compliance.

The CHAIRMAN. Thank you, Mr. Chairman. My time has expired.

I now recognize the gentleman from Minnesota for 5 minutes.

Mr. PETERSON. Thank you, Mr. Chairman.

Following up on that a little bit, one of my reservations as you know about moving forward on these bills is that we don't have the whole picture of all the rules, and we don't have all the rules in place and in effect, and we don't have a full picture of what this swap market is yet.

In your testimony you say you are 80 percent of the way completed with these rules, and by August, how much of the remaining 20 percent do you hope to have finalized, and are there any potential issue, outliers that may take longer to resolve, and if so, what are they?

Mr. GENSLER. We now have with the Commission full final set of rules on pre-trade transparency provision, the swap execution facility, and we are working through it in a very constructive way amongst the five of us to reach a consensus and move something out. The cross-border issues we look to finish up many of the big pieces, the guidance, by July, but there is certainly going to be more work internationally that will just continue on a day-to-day basis. We will address more issues about rural electric cooperatives and various electricity companies where we are planning certain exemptions.

So I think the bulk of what we need to do will be done by August, but one area I just want to mention that will still be outstanding is we purposely slowed down on finalizing margin for uncleared swaps—the issue that is so interesting to end-users. The Federal Reserve slowed down as well because we wanted an international agreement, and we have been working on that. We put something out in consultation last summer. We put a new document out I think it was in February, and that should point us to probably finalizing the margin rules closer to the 4th quarter of this year because we didn't want to move forward if there wasn't, as the Chairman said, harmonization on this key issue.

We have been advocating with the Federal Reserve and with the international regulators that there is not a requirement for the banks to charge a margin on this uncleared swaps for the non-financial end-users, but that is one piece that we are purposely waiting on until the fourth quarter.

Mr. PETERSON. I mean, you get unfairly blamed for this margin requirement. What is the discussion with you and these Prudential Regulators? They are the ones that are causing this problem, right?

Mr. GENSLER. Well, we have jurisdiction. You gave us jurisdiction if it is a non-bank, and of the 70 or so swap dealers we now have statistics. The majority of them are actually non-banks. They are often the affiliate of a bank. You know, they are the sister of a bank, but you have given us that jurisdiction.

I think we are pretty comfortable with what we proposed.

Mr. PETERSON. But the problem is that the ones that are banks that are regulated, they are telling their customers they are going to have to put margins on because the Prudential Regulator is going to require them to have margins. Is that what is going on?

Mr. GENSLER. Well, the proposal from the Prudential Regulators, the Federal Reserve and others, was that there was no specific requirement, but then they did include in the preamble several sentences that said, but, of course, if you are extending credit, you should do that consistent with your overall credit policies of the bank, and those key sentences in the preamble is what has been debated, and I don't know where the Federal Reserve will end up.

I know what we have been advocating is to be consistent with where we are.

Mr. PETERSON. Now, you have been advocating that these end-user, non-bank end-users shouldn't be required on this margin requirement.

Mr. GENSLER. Right. That it be just a matter of commercial, private negotiation.

Mr. PETERSON. Yes, but you think that the Prudential Regulators may come to the right conclusion at the end of the day?

Mr. GENSLER. I think so, because in February we put out a new consultation internationally, not just here domestically but internationally, that included that the end-users would not be caught up in this. So that is what is this last international document that was put out and should be finalized by the summer.

Mr. PETERSON. Right. So, I mean, this has been a big issue that has been going on for 2, 3 years. We have bills introduced and all this stuff, am I right that it is premature to be passing bills before we know what the final outcome of this is going to be?

Mr. GENSLER. I think that you gave us clear direction on this and clear authority. We have the authority to finalize it the way you wish. The CFTC is doing that. The international consensus is aligned with what your Committee's views are or at least your views were.

Mr. PETERSON. Thank you. Thank you, Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Texas, Mr. Neugebauer, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Chairman Gensler, it is good to have you.

I was particularly interested in your testimony about some of the things that you are doing on LIBOR. As you know in another committee assignment I had we had some discussions about LIBOR, and can you kind of give me a blueprint of kind of where we are headed with that, and what kind of timeline, and who are the market participants that are working on this issue?

Mr. GENSLER. I thank you, and I thank you for your leadership on these issues because I know you have been looking at in the Committee. Where we are is there is a market called Interbank Lending, bank-to-bank lending without posting collateral. It is called the unsecured market or it was. What we know is it is essentially non-existent now due to a lot of changes, structural changes in the banking market and also new rule changes in the Basel Committee's capital rules.

So since 2008, we have had LIBOR referencing something that essentially is non-existent, and we have had these three large cases that have led to $2.5 billion in fines at Barclay's RBS and UBS, but I don't think that is the central part of the story. The central part of the story is what do we do when a market is referencing something that is not actually trading, and if it were just not trading for 3 days or even a week or 2, that would be one thing, but this is long term.

So the international regulators, both bank regulators and market regulators, have been pursuing dialogues and discussions, security regulators have a consultation out on best practices and also looking at if we were to transition how to smooth that transition. This would not be easy to transition from U.S. Dollar LIBOR to something else. It would be very challenging, should take a long time, it should be smooth, because it is so embedded in the financial system. There have been a lot of market participants involved either by written consultation or brought into round table discussions. But this goes well beyond the U.S., well beyond the CFTC because the system uses this rate in so many ways even though the rate, I think, long term is not sustainable.

Mr. NEUGEBAUER. So is the direction it is moving is that currently there are different currency LIBORs, Euro LIBOR, U.S. LIBOR? Are you moving to continue to have a rate in each currency, or are you looking for a larger, a universal number that everybody is working off?

Mr. GENSLER. So what the international securities regulators came around to in this public consult is that any benchmark to be viable and reliable should be anchored in real transactions. It is sort of like if you were to buy a home, and you asked your realtor what are the comparable prices in the neighborhood, you would like to know what the comparable price is. Now, if there is no transactions for the last 4 years, that leaves you guessing what to pay for that house.

So to anchor in real transactions, Martin Wheatley, who runs the Financial Services Authority in London—has already recommended last summer—he recommended that there shouldn't be Canadian Dollar LIBOR, Australian Dollar LIBOR, and six other currencies. He said there just isn't enough there, but then that brings us back to the question about U.S. Dollar LIBOR, Euro LIBOR, and like you said, those are more challenging because they are so part of the financial system. We have this fragility of relying on something that may not be referencing a true market.

Mr. NEUGEBAUER. Are any of the Fed's benchmarks being considered? And the only reason I ask you that is because the Fed has the ability, obviously, to manipulate that but in many cases that does trigger other transactions, in other words, the discount rate or Fed funds rate, those kinds of things that would reflect what banks could either borrow from the Fed or could borrow from each other.

Mr. GENSLER. There are three or four different alternatives that market participants have been chatting about. One of them is something called overnight index swap rate that does ultimately refer to in an indirect way to overnight funding rates for the banks, but it is based on real transactions. Other things people are looking at are there rates based on how people do collateralized lending, general collateral or repurchase agreements? There is even looking at the treasury yield curve and so forth.

Mr. NEUGEBAUER. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. DAVID SCOTT of Georgia. Thank you very much, Mr. Chairman, but I must say at the outset that it is somewhat unfortunate that we are trying to pack so much into one relatively brief hearing. Each of these bills we are examining today deal with very complex issues that entire armies of lawyers are paid to try to understand, and while the idea's embodied in these bills are not new, a great many of the Members of this Committee are, so in my humble opinion it would be preferable to break some of these bills into just a few hearings so as not to force our Members who are new to Congress and new to this Committee to sort of drink from a fire hose.

So I am hoping, Mr. Chairman, that at least we will get one more bite of the apple before we pass this, but nonetheless, this is the hand that we dealt, so here we are.

I do want to say at the outset, however, that I am supportive of these bills that we are discussing today, because I think it is very important for us to emphasize that none of these bills, neither in spirit nor in letter, seek to undermine the regulatory regime prescribed by Title VII of Dodd-Frank. Rather, they all seek to address areas of either statute or rulemaking that require clarification and adjustment, and that is why all of them have historically had strong bipartisan support both in this Committee and the other Committee I serve on, Financial Services.

It is in my opinion that these bills will not lead to new loopholes, these bills will not lead to lax regulation, and they will not lead to another Wall Street meltdown. These bills are not about protecting the bottom line of big banks or helping the exchanges skirt regulation. The legislation before us today is about keeping the cost of doing business down for end-users of derivatives, whether they are big companies like Delta Airlines or Home Depot or small and large farms and ranches in our districts and allowing them to continue to hedge price risk.

This, in turn, helps keep costs down for consumers, and the ideas contained in these bills are not incompatible with the stated goals of Dodd-Frank on transparency or customer protection. We must not be afraid to make changes to Dodd-Frank where they are warranted, particularly to portions that may not work as we intended them to do or may have unintended negative consequences.

So with that said, let me turn to you, Chairman Gensler, and ask you about an issue that I have raised with you many times, and that is the extraterritorial application of Dodd-Frank rules. It would seem that with the application of clearing and margin requirements as well as swap dealer and major swap participant registration and reporting requirements would prevent any risk of another AIG-like market failure, and yet the cost of such extraterritorial application would be quite substantial, not to mention the risk to U.S. competitiveness in this space.

Given developments late last year unnecessary disruptions around the October 12, deadlines, last-minute, no-action letters reports that foreign banks wouldn't do business with U.S. firms and interim final rules.

Let me ask you why should Congress have any level of confidence that you are moving in the right direction and that markets won't be negatively impacted by the actions of the CFTC with respect to extraterritoriality, and also how do you intend on getting the rest of the world to follow the United States when the SEC and the CFTC rules currently don't align on timing, process, or content in many areas?

Mr. GENSLER. I would hope that you would have confidence in any agency that was handed an enormous task and has largely completed it, that we have had 40,000 public comment letters and 2,000 meetings, and we have actually addressed where we need to move in moderation or even re-proposed rules in a number of circumstances.

I think also on the cross-border side I just raised, that even the bills before you could blow a hole in the bottom of Title VII with all respect because whether it is through booking something in an affiliate or booking it offshore, that risk will and does come back here. That is exactly what happened in AIG.

Mr. DAVID SCOTT of Georgia. Let me ask you, what would happen later this year if there still is not an international harmonization or even domestic harmonization?

Mr. GENSLER. We will continue to work, I think, very closely with the international community. We will not be exactly the same, but where there are conflicts, we are taking a very pragmatic approach. We have worked through a number of them with Japan with Mr. Masamichi who testified here in December. They have a clearing requirement, we have a clearing requirement. They were actually tightly aligned, but there was a conflict, and we did one of those no-action letters so that U.S. firms can clear in a Japanese clearing house, for instance.

So where there are conflicts, we have been pragmatists, and that is what has led to a lot of these no-action letters is trying to adjust and moderate.

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

Mr. CONAWAY [presiding.] The gentleman's time has expired. Thank you, Mr. Scott.

I now recognize myself for 5 minutes.

Chairman, thank you for being here. Welcome.

Following up on the cross-border jurisdiction issues, are there countries now that you trust their regulatory scheme to be good enough that you could go ahead and grant them the substituted compliance designation like Japan or EU or Canada where at least with respect to those jurisdictions you could put these kinds of questions aside without a lot of hassle?

Mr. GENSLER. I think it is an excellent question. There are six jurisdictions overseas; just six that have registered swap dealers with us; Europe, Switzerland, Canada, Japan, Australia, and Hong Kong. We have reached out to all six and said, let's get going because we could probably identify maybe not all the rules but a substantial number of them where we can look to that home country's substituted compliance, and we made some good progress with Canada and Europe in some of those discussions.

Mr. CONAWAY. Are there any of the six that you don't out of hand trust?

Mr. GENSLER. I trust all of my fellow regulators, but their laws and rules are sometimes a little different than ours. So it is a question of whether, technically whether they are comparable and comprehensive. Let's say they have a clearing requirement that it is comparable enough. It doesn't have to be identical.

Mr. CONAWAY. All right. So perfection is the enemy of the good here, is it?

Mr. GENSLER. No, no, no. It has to be comparable and cover the sort of waterfront but not identical.

Mr. CONAWAY. One of these comes up from time to time that we generally vehemently oppose is some idea of combining the SEC and the CFTC, and one of the fodder for that idea is that you can't do joint rules. You have a U.S. person rule that for the SEC's one kind of a U.S. person, and you have a different one. Why can't you guys get together so we can put some of these kind of arguments aside, because quite frankly, I think that would be in the worst interest of the overall scheme to try to combine you, but those kinds of apparent lack of cooperation, for lack of a better phrase, give people fodder for that idea.

Mr. GENSLER. Yes. I want to say that I do share your view about it I don't think it would benefit the American public to——

Mr. CONAWAY. I don't either.

Mr. GENSLER. All right. We are together on that.

Mr. CONAWAY. Absolutely.

Mr. GENSLER. But in terms of coordination, we are coordinating with the SEC. You granted this agency oversight of about 95 percent of the swaps market, and SEC has about five percent. On U.S. person, more specifically, we put out a proposal on guidance last July. We have actually narrowed it to a more territorial approach, and I think we put that out in December. We had one set of questions left about offshore commodity pools that are still for the benefit of U.S. persons managed here in the U.S. But that narrower territorial approach actually, I think, has been working reasonably well.

That means if you do a trade offshore even with a guaranteed affiliate, it doesn't get counted like it does to this more territorial U.S. person approach.

Mr. CONAWAY. Well, let the record reflect I vehemently oppose that idea because I do think the public would be harmed by it, but the closer you can work together on joint rules like that, obviously the better.

We have the cost-benefit legislation that my colleagues and I have proposed last year, passed the House with overwhelming bipartisan support, would require the CFTC to come in line with the President's Executive Order of cost-benefit analysis.

Do you oppose that idea? Is that not in the best interest of the regulated?

Mr. GENSLER. I think that considering costs and benefits have benefited our rulemaking. I think we have done it better because we have focused on those costs and benefits. There are many choices, though, that Congress makes—we are delegated authority—but you make the key choice, whether there is clearing, whether there is public transparency and so forth, and so I think just to raise the concern that you wouldn't want us to have to reconsider the things that you have already decided in the eyes of some cost-benefit.

Mr. CONAWAY. Chairman, you are wonderful at answering, but the question was do you oppose the legislation?

Mr. GENSLER. Oh, the legislation? I think the legislation would make our jobs quite a bit harder. In the future, whether there are tweaks to any cost-benefit in the Commodity Exchange Act, we will live with it, but it may well be hard to get any rule out of the building.

Mr. CONAWAY. Okay. Speaking of the building, there is a report out that there is a data access issue with respect to the Office of Chief Economist. Can you talk to use about when you knew about it, did you approve the program in its inception, or just kind of quick snapshot of what is going on there.

Mr. GENSLER. So our Chief Economist Office for years, maybe decades, has done research on data that comes into the building and sometimes publishes some results and puts that out to benefit the public and benefit the markets. They also have, and this is for many years, used some outside consultants and academics who are credentialed and signed in. There was a question that came to our attention in December about at least one research report written by an outside academic as to whether they had the right to use the data and so forth. It came to my attention then. We immediately started to look at our credentialing, how are they documented, what sort of documents they signed, and so forth. And what we did at that point in time is we said let's for the moment just shut down the use of any outside academics, consultants as we found some that our documentation and internal controls weren't fully up to snuff. We shut it down promptly, and we referred it to our Inspector General.

Mr. CONAWAY. Okay. Well, if you decide to do something again in that arena, we would appreciate being briefed on the internal controls and the other things that you are going to put in place.

Mr. GENSLER. I think that is a good idea that we would do that.

Mr. CONAWAY. All right. My time has expired.

Mr. Enyart, Illinois, 5 minutes. Bill. All right. No questions.

Mr. Vargas.

Mr. VARGAS. Thank you very much, Mr. Chairman. I appreciate the opportunity.

You did comment when you first got here that you were quite restrained, that we had given you an enormous task, and you were quite restrained because of resources. Could you comment a little further on that?

Mr. GENSLER. Well, we have 684 people. That is about 50 more people than we had 20 years ago or seven percent more than we had 20 years ago and a little smaller than a year ago. In that time Congress gave us the job to oversee the swaps market that is eight times larger in risk than the futures market that we had overseen.

So we think that we need about 1,000 people, and we also need significantly to grow the technology, and I know this is hard because Congress is grappling with big issues about the Federal budget, and an extra $100 million for this small agency is hard to find, but I think it is a good investment for the American public, and simply put we are not right-sized for the mission that we have right now. We just simply don't have the staff to do the examinations, we don't have the staff to do the enforcement. Our enforcement staff is smaller than it was, I think, 2 years ago or about the same size, and though it is not a way to measure it, these LIBOR cases brought in $2 billion to the U.S. Treasury, and the last 12 months we are funded at about $200 million.

Mr. VARGAS. And a follow-up question with respect then to sequester. Is the sequester in any way causing havoc in your agency or not really, or how it is affecting you?

Mr. GENSLER. It pinches us. It definitely pinches us. As I said, we are a little smaller than we were a year ago. We were cautious this year because frankly I thought it was a reasonable possibility that we would end up with a sequester, and maybe I am a man that came from markets and playing the odds or something, but so we have been cautious, and so we are able to make it through the next 6 months we think without furloughs, but we are just not in the right place. We shrank a little bit over this last year to prepare for sequestration. We are not spending enough on technology either.

Mr. VARGAS. You mentioned that there are six international regulators, and where do you find the convergence or divergence with them on the issues that we have been discussing so far?

Mr. GENSLER. Geographically we are best with Europe and Japan because they are further along. They have passed their legislation, and they have put in place most of their rules. Canada almost as far, Australia and Hong Kong have more work to do legislatively.

In terms of substance, in terms of policy where we are closest is central clearing seems to be a good, solid, strong, international consensus, data reporting to the regulators, strong international consensus, and some of these margin issues, actually a growing consensus. Where we are less close is whether the public gets the benefit, the end-users get the benefit from seeing the price in volume and transparency. In our country we have benefited since the 1930s in the securities markets, the futures markets, and I think we come together actually across the philosophies that transparency is a good thing, but it does tip things away from Wall Street, and so it shifts some information to the public, to the end-users, and that consensus isn't as well formed in some of the other jurisdictions around the globe.

Mr. VARGAS. Like which ones?

Mr. GENSLER. In Europe they are still putting that in front of their European Parliament, and they look to try to finalize that this summer, so I think they are going to get there. It feels very good that they will get there. Japan has it but more narrowly than ours, and then other jurisdictions do not have the public transparency components like Hong Kong or Singapore for instance.

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

Mr. CONAWAY. The gentleman yields back.

Mr. Austin Scott for 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman, and many of the questions that I had have been asked, but I do want to commend you, Chairman, for the statement that you made that you actually prepared for the sequester. That is not something that we have heard from many of the people that were in charge of their agencies.

Mr. GENSLER. I thank you. I just was reading the newspapers.

Mr. AUSTIN SCOTT of Georgia. Yes. I majored in risk management, so I think that it was just prudent to prepare for it once it became the law of the land, so thank you for running your agency like that.

I think the other thing I would just reiterate that has been talked about a good bit here is that making sure that we are able to maintain the difference in the end-users who don't pose a systemic risk to the markets and the others who do pose a risk, and with that said, H.R. 634 is before us. We passed this bill last year, 370 to 24. It is the legislation that simply, essentially says that if you are an end-user and you qualify for the clearing exemption, you would also qualify for the margin exemption.

Again, it passed 370 to 24 last year in the House. We are going to be dealing with it again this year, broad bipartisan support. It was not taken up in the Senate.

Do you have any thoughts on that that you would care to share with the Committee?

Mr. GENSLER. The non-financial part of our economy employs 94 percent of private-sector jobs, and Congress came to a judgment that those parties who only, if I can use another statistic, only make up about nine percent of this swaps market. So 94 percent of jobs, if I can say it that way but nine percent of the swaps market. Congress came to the judgment that the Administration supported that they didn't have to come into central clearing. Consistent with that we have proposed that they are not caught up in margin.

Mr. AUSTIN SCOTT of Georgia. The margin.

Mr. GENSLER. The margin and I think that is where we will end up as a final rule later this year as well, and that is what we have been advocating with the international community.

We have also looked at whether end-users should have more time to report their data to the data repositories. In every spot we reach out to many of these end-user communities, and you will hear from some of them later today.

Mr. AUSTIN SCOTT of Georgia. Yes.

Mr. GENSLER. As to how we can accommodate to make sure that this might touch them but touch them lightly.

Mr. AUSTIN SCOTT of Georgia. Okay. One last question if I might. I have been through 50 Committee hearings. So is the President going to sentence you to another 50 hearings or——

Mr. GENSLER. I guess you maybe have read some news reports. There are ongoing discussions about that. It is a terrific honor to serve, privilege, and I hope that a significant part of my remaining professional life is in public service. So I think this job is terrific, and appearing before this Committee is terrific.

Mr. AUSTIN SCOTT of Georgia. Up until that I think your testimony was very honest.

Thank you, Mr. Chairman. Thank you, Mr. Gensler. I yield the remainder of my time.

Mr. CONAWAY. The gentleman yields back.

Mr. Gallego from Texas, 5 minutes. No? All right.

Mrs. McLeod for 5 minutes. No?

Anybody else? Mr. Nolan, 5 minutes? All right.

Mr. Crawford.

Mr. CRAWFORD. Thank you, Mr. Chairman, and before I begin with questions, I would like to thank both panels for being here to testify today about the current state of Dodd-Frank implementation, particularly thank you to Mr. Larry Thompson, General Counsel, for the Depository Trust and Clearing Corporation, who has come before the Committee before to testify particularly on the merits of legislation H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013. I certainly appreciate my colleague, Congressman Sean Patrick Maloney for joining me as a cosponsor of this bill, and finally, Chairman Gensler, I would like to thank you as you are charged with the difficult task of improving market transparency and systemic risk mitigation and global derivatives market. I am hopeful the CFTC will achieve these goals, and I introduced H.R. 742 to fix the Dodd-Frank provision which threatens to undermine the bipartisan goal of enhancing transparency and mitigating systemic risk.

Currently Dodd-Frank law includes a provision requiring a foreign regulator to indemnify a U.S.-based SDR for any expenses arising from litigation relating to a request for market data. Unlike most of the world, the concept of indemnification is only established within U.S. tort law. As a result, foreign regulators have been reluctant to comply with the provision, and international regulatory coordination is being thwarted.

While the idea of the provision was to protect market confidentiality, in practice it threatens to fragment global data on swap markets. Foreign regulators would be forced to create their own SDRs, resulting in fragmented global data framework where regulators can't possibly see a complete picture of the marketplace. Without effective coordination between international regulators and SDRs monitoring and mitigating global systemic risk is severely limited. H.R. 742 fixes this problem, and while the CFTC seeks to clarify this provision through interpretive guidance, all indications are that there is no viable solution without adopting my legislation as we will hear from Mr. Thompson later in the day.

So with that I have the following question for you, Chairman Gensler. Recently your colleagues, Commissioners Sommers and Chilton both testified before this Committee and agreed that H.R. 742 is a necessary fix to the indemnification provision of Dodd-Frank. The SEC testified to that same effect before the Financial Services Committee last year.

Do you agree or disagree with your colleagues?

Mr. GENSLER. I think that you have provided us in title VII a great deal of flexibility, and we have used that flexibility in the interpretation we have done. The bill as I understand it is consistent with that, and certainly international regulators would like that extra step. I mean, what we did in the interpretation that we put out—that you referenced—is that international regulators, if in their statute, anywhere in that statute they have authority to get that information, then the indemnification doesn't apply.

So we interpreted it, I think, just about as broadly, but your bill certainly just goes further by just removing the indemnification altogether.

Mr. CRAWFORD. You have indicated that interpretive guidance would be enough to address the indemnification problem, so I think as you indicated global regulators disagree and have expressed that they actually support the legislative approach. I am just wondering why there was a difference of opinion there.

Mr. GENSLER. Well, we have addressed it. I think that in some circumstances global regulators would like to see information that they don't necessarily have authority to see, that their local laws or legislation haven't given them the authority to see, and so I think as they have expressed to us, for instance, they might want to see in these data repositories information about U.S. traders who might do a transaction referencing one of their government rates or something. So they wanted to go a little further in what they could see.

Mr. CRAWFORD. Okay. Why are reforms like cross-border guidance at CFTC being made through interpretive guidance and staff no-action letters *versus* a formal rulemaking process? Shouldn't the CFTC follow the Administrative Procedures Act requirements?

Mr. GENSLER. With regard to guidance we do follow the Administration Procedures Act quite closely. There have been four or five places where we were not asked to do rules, but somebody has come in and said can you interpret some words in a statute, and this cross-border provision is something that Congress put in—it is actually technically called Section 722(d)—that did not have required rulemaking. Furthermore, is not in the provisions for the Securities and Exchange Commission. This was one place that it was not the same.

And so we had a lot of people come in. We debated whether we just left it to facts and circumstances, issue no interpretation, or put out an interpretation, or third, put out an interpretation subject to public comment. We chose the third to get the public input, and yes, we have gotten a lot of public input. I would include this hearing in that public input. So it has been very helpful to interpret these words, and I think give guidance.

Mr. CRAWFORD. I appreciate that. You anticipated my next question so I don't have to ask it. I am out of time. I appreciate your being here, Chairman Gensler.

I yield back.

Mr. CONAWAY. The gentleman yields back.

With apologies to Mr. Maloney from New York for skipping a while ago. Sean, you are recognized for 5 minutes. Sorry about that.

Mr. MALONEY. That is quite all right, Mr. Chairman. I am the youngest of six kids. I am quite used to it. My mother says I was lucky to get a name, Mr. Gensler, at the end of five brothers.

Listen, I want to reiterate the comments of my colleagues and commend you on what I think is really extraordinary public service. I was with a very significant player in a marketplace that you oversee just on Sunday night, and he said to me there are a dozen or so guys in Chairman Gensler's position all over the globe, and he is the only one getting anything done, and regardless of the minor differences, a lot of the people you oversee have with each of the decisions you have made, there is from my perspective a real growing consensus that you have been extremely effective given the extraordinary responsibilities that Congress has placed on you recently. And so thank you, first of all, for the work you have done. I think it is extraordinary and critical to the functioning of these markets. When I was last in Washington, I was working in the White House for President Clinton, but when I left, I ran a commodity derivatives risk management company, and we made software to try to get at some of the very issues for the commodity derivatives market that we are still wrestling with in the larger derivatives markets.

So I have been an observer of this space for a decade, although I am a little rusty having worked in other areas since. But I am particularly concerned about your comments about the resources that you have been provided, and I want to give you a chance to elaborate on that because I really would like you to be able to inform the Committee what the world is going to look like if we don't right size your agency given the extraordinary increasing responsibilities that we have bestowed on you.

Mr. GENSLER. I thank you. I am one of five children, and I am at the bottom end, too, so I know that which you speak of.

I think it is also about risk assessment. I think that a wrong-sized agency can survive for a while and then at some point something kind of pops up. We don't have the staff right now. We don't go into the big clearinghouses annually as Congress directed us to do for the systemically important ones; Chicago Mercantile Exchange, ICE, and LCH. We don't really have the staff to do examinations of the future commission merchants and now the swap dealers.

Now, we first rely on the National Futures Association, but we feel some obligation to have back up and to have spot checks and to move in from time to time. We don't really have the staff to answer all the hundreds of questions that are coming in. The futures industry comes in with questions, the swaps industry, and we do our best, but it would be better to have more people, and in the enforcement side we don't have enough people on the enforcement side.

I liken it sometimes to if the National Football League took on eight times the number of games—because we have eight times the number of risks that we are overseeing—and kept the same number of referees, and so you would have one ref per seven games, and then one game wouldn't even be reffed.

And I think what we know would happen in football is it would be a rougher, tougher game out there probably, but the fans over time would lose confidence, and I think the analogy is the investors at some point would lose confidence because there would be some major hiccup, everybody would haul us up here, I would be up here for my 76th hearing, and it would be, well, why, Mr. Gensler, did you let this happen, and nobody would want to hear because we didn't have resources. I mean, the American public needs some protection and oversight, and so I think that is where we are.

Mr. MALONEY. Well, thank you for that, and in the time I have remaining let me just cut the other way a little bit. I mean, do you feel that you also have a role in reducing the regulatory burden of some of the firms you oversee, and where do you think, if there are areas where Dodd-Frank went too far or where we could reduce both their burden and yours, what would you like to see us do?

Mr. GENSLER. Well, I think title VII coupled with a provision that was passed 20 years ago which gave the Commission exemptive authority, where we can exempt some provisions if it is in the public interest, has worked very well. We have taken to heart end-users, non-financial companies that are 94 percent of jobs but only nine percent of the market and tried to give them more time. There were issues that were focused on in the inter-affiliate area. I know there are bills here that I might have concerns about because I think you could really undercut this. We are going to address the inter-affiliate issues, and we have something in front of Commissioners to finalize it.

We have end-users coming in about something called the treasury function. If they set up a treasury function, how to address that, but, again, I think our exemptive authority gives us pretty good ways to craft things. Where we can't we would come to you, but I think we have some pretty good authorities, and we look to your advice and guidance on these things as well.

Mr. MALONEY. Thank you, Mr. Chairman.

Mr. CONAWAY. The gentleman yields back.

Mr. Denham from California, 5 minutes.

Mr. DENHAM. Thank you, Mr. Chairman.

Mr. Chairman, I wanted to follow up on that same line of questioning on the regulatory level. First of all, my belief obviously with Dodd-Frank was it was designed for the big banks, yet in my community we are dealing with a lot of challenges on a day-to-day level with some of my smaller irrigation districts.

Do you think that it is appropriate that that long reach goes all the way down to the irrigation districts and some of their day-to-day activities?

Mr. GENSLER. I would like to follow up with you and understand what they have raised, because if I think of an irrigation district, they would be an end-user. They wouldn't have to use this clearing and margining. I would like to find out and if there is some practical issues there that we could explore together.

Mr. DENHAM. Thank you. I will send you some of those details right after this hearing and certainly would love to follow up with you on a meeting.

Mr. GENSLER. You know, it would be very helpful if we got such details, and we can then follow up a week or 2 later and then sit down and see what the issues are.

Mr. DENHAM. Thank you. Just one other question. Do you believe that the swap execution facilities should have five RFQs?

Mr. GENSLER. Congress incorporated in the bill a provision to promote transparency that buyers and sellers meet in the marketplace and compete in the marketplace, and it actually used words that it would be multiple parties having the ability to transact with multiple parties. Roughly. I don't have the words.

We proposed that there are a number of ways to do that. The traditional way which is called an order book where everybody sees the bids and offers and the whole market sees it, but as an alternative also because this is a little bit different market, a more narrow focus called a request for quote that you could go out to a smaller number. We proposed five. I think that that is an appropriate level.

I would note there are 73 registered swap dealers. It is not a small community, and even though some of those are multiple in a company, there are at least 35 or 40 separate families or big companies making markets.

I would also note this requirement would only be in the big interest rate markets, the big four currency markets that we have a clearing mandate and for the big credit default swap entities that were at the heart of this marketplace. So it is narrow that way as well.

And last, I would note you gave us authority to exempt from this any large notional size transactions or what people usually call block trades. So it is only those markets that are liquid enough to be cleared. There are 73 registered swap dealers, so it is not like there is only a handful of them. It is not about energy or agriculture or metal products because we don't have a clearing mandate on those at this time.

Mr. DENHAM. The SEC has an alternative proposal on what the mandatory requirement is. Why the difference between the two Commissions?

Mr. GENSLER. They had also included something which I know it is in the weeds, but it is called order integration. They said if there is an order book, you must go to that, and that gets what is called time and price priority. We did not do that. That is more central to their marketplace than the futures marketplace and what we proposed. We didn't do this for the swaps marketplace.

There are also many, many things that are identical in their swap execution facility rules, proposals, but those tend to get less focus, of course. This issue is one, but, again, we are working through this, the five Commissioners. We have done most of what we have done unanimous. Many other things bipartisan. We seek consensus at the Commission. We are not there yet on this one.

Mr. DENHAM. Thank you. I would like to follow up with you on that one as well. And just to clarify, I understand that I call things somewhat differently than you do. Our irrigation districts are your special entities. That is the challenge in the regulation on irrigation districts, but I will follow up with you on that as well.

Mr. GENSLER. Okay. I look forward to that.

Mr. DENHAM. Thank you.

The CHAIRMAN [presiding.] The gentleman yields back.

The chair now recognizes the gentleman from Florida, Mr. Yoho, for 5 minutes.

Mr. YOHO. Thank you, Mr. Chairman.

Mr. Gensler, I appreciate you being here, and it is an honor to be here, and I heard you say that, too, and I also want to reiterate what Austin Scott said that you prepared for sequestration, and I commend you for that.

You know, the Dodd-Frank financial reform bill, it came out, it was such a massive change to the economy. It was something we needed some oversight and some of those things granted, but it also created so much confusion in the marketplace, and what we need now is jobs, and what we have to do right now is create that certainty. And I look through this, and I look forward to these bringing that certainty to parts of the market.

But one of the things here it says, excuse me, it says, "Congress never intended for the end-user to be subject to expensive margin requirements which would require companies to take capital away from their businesses and hinder their ability to make job creation investment."

We see that in the community banks in our area in north central Florida. We have a lot of the community banks that the farmers go to, and it is impeding them in doing business, and the more clarity that we can bring to that would be great, and I look forward to working through those proposals for you.

And one question I do have for you is it is my understanding that there are five different definitions of *hedging,* including separate definitions within the same rule. Do you think this provides clarity for the regulated community?

Mr. GENSLER. You know, it is an interesting challenge being at a regulatory agency and sometimes a hedging exemption Congress would want it to be wide and sometimes they would want it to be narrow, depending upon the circumstance, whether it is related to position limits or this clearing exception and so forth.

We made it very wide with regard to the clearing exception, and I should mention we also used our exemptive authority to exempt community banks, those smaller than $10 billion, thousands of banks in this land, from the clearing exception. So the vast majority of banks are treated like non-financial end-users as well.

But sometimes the words in the statute and sometimes even the intent of Congress is to be wide or narrow, and in the clearing requirement it was pretty clear you wanted us to be pretty wide to give these end-users an out from clearing if they were hedging.

Mr. YOHO. Okay. Following up with that, is there any harm in using just one common definition? Why or why not, and if you could discuss that a little bit.

Mr. GENSLER. There could be. I think if we were to use the same definition and position limits and people debate whether they are for or against position limits, but I think it is pretty clear Congress in Dodd-Frank and for decades earlier wanted us to have them, you probably exempt almost everybody from position limits even the speculators. I mean, the way that we sort of wrote the hedgers out of clearing was very wide and was not the same words. They are not the same Congressional words because in the position limit area it talks about *bona fide* hedging in a different way, but I think it would not be appropriate to use the same definition and position limits because we would have to then be too narrow in the clearing exception.

Or you might say, well, that would be good because you would just basically gut position limits, one way or the other.

Mr. YOHO. All right. Thank you.

Mr. Chairman, I yield back the remainder of my time.

The CHAIRMAN. The gentleman yields back the balance of his time.

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

Mr. LAMALFA. Thank you, Mr. Chairman, and for having this hearing.

As we know, regulations hopefully well intended, can have sometimes an adverse impact on people's lives and sometimes it is unclear what the benefits may be from some of those regs.

For example, public utilities like I have in my district and probably common to many areas of the country, are seeing their access to energy supplies cut off by arbitrary regulations.

So without a correction I think one of the byproducts of this portion of Dodd-Frank may be increased cost for electricity and gas bills for regular rate payers all around the country, which to me, especially at this time is unacceptable or not when it is hard to see what the benefit really is. So myself and my colleagues, Mr. Vargas and Mr. Denham and a few others have joined in on a bill, H.R. 1038, which would allow government-owned utilities to continue managing their risks, with many of their former counterparties who have continued to walk away from even in like the ability to enter into these agreements because of the CFTC's non-binding no-action letter.

So I wonder would you support what we are trying to do in a very narrow scope of H.R. 1038?

Mr. GENSLER. If I could just mention a little background that emanated in Dodd-Frank from the Senate side but just a little background, there was a provision in the final bill that there had to be enhanced sales practices and enhanced protections for transacting these swap transactions with what was defined as special entities, which included municipals and pension funds or certain pension funds.

We sorted through a second provision, where Congress gave us authority to further define a swap dealer and a *de minimis*, if you were less than a certain level, you didn't have to register as a swap dealer. The special entity provisions were to provide greater protections of whether it was for a municipal electric co-op or just a municipal government or as I said, pension fund.

Mr. LAMALFA. Certainly, and I know my time is limited, I am sorry, so I guess what we are finding in practice, though, is that people are pulling back from entering into these agreements, and so my bottom line is H.R. 1038, do you feel in its narrow scope a supportable measure?

Mr. GENSLER. Well, I haven't read it in detail so I——

Mr. LAMALFA. Okay.

Mr. GENSLER.—want to stay away from that but let me just——

Mr. LAMALFA. Let's move from there then.

Mr. GENSLER.—I think the policy issue that we will be addressing is the protection of those entities, those protections, those sales practice protections, those that you want to be at that level. We did use that to make it easier.

Mr. LAMALFA. I am sorry. Let me ask on that. Has there been a problem in the past? What role did public power companies play in the crisis we have seen before then?

Mr. GENSLER. They didn't play a role or any material role except for they were the losers in a sense by a crisis. Their jobs and their markets were hurt. I think that what we did was we recognized this, we gave exemptive authority, we raised the *de minimis*, meaning you don't have to register as a swap dealer unless you do more than $800 million of transactions with special entities, and we did that because the one comment letter we got on this gave us a ratio to make it 1⁄10 of the overall *de minimis*. So we were reacting to comment letters as well. At the time the comment letter came in they suggested $300 million. We went to $800 million, but again, I respect that some of these rural electric cooperatives think it should be higher.

Mr. LAMALFA. Yes. We are looking to level the playing field with the independent utilities as well, which has $8 billion. What they are running into is that they don't believe that what is called the no-action letter gives them enough certainty to be able to operate. This would be like driving through a town where the speed limit says 25 miles an hour but everybody says you can go 50. Well, you don't know if they are going to enforce that or not. So the no-action letter that says that they can go up to the $800 million, do you believe that really provides them with the certainty they need?

Mr. GENSLER. The history of our regulatory system, these no-action letters, have given people a lot of confidence. I understand the metaphor, but I think it is more than that. The staff recommends not to bring an enforcement action. The Commission doesn't then sort of impose and without a lot of public notice, and I think we have maybe withdrawn two or three no-action letters in the last 20 or 30 years, but then we do it, and people know it, and it is public and——

Mr. LAMALFA. The input we are getting is that people are pulling back and drawing out of it, so I am out of time. Thank you.

Mr. CONAWAY [presiding.] I thank the gentleman. Mrs. Hartzler for 5 minutes.

Mrs. HARTZLER. Thank you, Mr. Chairman. Thank you, Chairman Gensler, for being here with us and for working and listening to people as you have implemented these rules, and I have heard of some positive outcomes, and people are feeling like that you are being responsive. And so I don't know if we are completely there, all the concerns are aligned, but I know you are trying, so thank you for that.

I wanted to ask a little bit about MF Global, kind of switch topics just a little bit because I have a lot of constituents in my district that were impacted by that. I know we are kind of winding up that situation there, but I wondered first of all if you could kind of give your perspective on how that happened and kind of summarize the recent findings and suggestions for changes to see that that doesn't happen again.

Mr. GENSLER. One, I want to thank you. There is always more work to be done, so if there are issues, we want to address them.

On MF Global, and I don't know if you are aware, within days after the collapse of MF Global and as it turned to a possible enforcement action involving senior executives of MF Global including Jon Corzine, who I once had worked with now 15 years ago at Goldman Sachs, I stepped aside, I am not participating and have not participated in these last 18 months or so since that occurred, but certainly we could take that question back. John Riley is here and could get it back. Commissioner Sommers heads up from the Commission to get you——

Mrs. HARTZLER. Yes.

Mr. GENSLER.—details that you just asked about.

Mrs. HARTZLER. Okay. Well, the Committee here has been aware of a recent internal report conducted by the CFTC lawyers on whether you were required to withdraw from matters involving MF

Global, and the Committee has seen recent press which essentially said you were not required to withdraw and from a legal and ethical perspective your participation in Commission matters involving MF Global were not improper.

As part of the oversight mandate of this Committee, we have an obligation to understand fully this, including the contents of the December 13, 2012, memo.

So I wondered if you could please provide a copy of the memo by the end of this week?

Mr. GENSLER. Sure. I think it is actually on our website, but we will certainly get it to you directly.

Mrs. HARTZLER. Great, and has this internal report altered your daily activities into the investigation and your subsequent rule proposals for customer protection?

Mr. GENSLER. It has certainly changed my involvement. I am not in any way participating in that investigation.

With regard to rulemaking, rulemakings of general applicability, I have been involved with that, voted on the proposals as staff recommended, those proposals last October, which have brought applicability to the marketplaces.

Mrs. HARTZLER. Okay. Great. There has been another recent press report about a possible serious data breach at the Commission surrounding the OCE Net Program run by the former chief economist, who is now a professor at MIT.

So how familiar were you with how this program operated during its existence, and what are you doing to investigate what happened?

Mr. GENSLER. We have had for many years, well before I was at the Commission, a Chief Economist Office that works and does research on data but also uses from time to time outside consultants, academics that are then credentialed in to maintain that confidential information. In December it came to our attention. Somebody contacted us and said they saw a research report by one academic, and though that research report didn't name any specific data by any one market participant, they wanted to know how does that work.

And we started looking at it immediately, and I promptly directed that we should suspend any of the outside consultants. So what we found that there were some concerns about internal controls, about whether they were fully documented as signed, their non-disclosure agreements and things like that.

We also promptly referred it to our Inspector General. We have been conducting a management review, but we also see the benefit of having an independent IG look at it as well.

Mrs. HARTZLER. Very good. Did you know how OCE Net operated?

Mr. GENSLER. I have learned a lot about it since December.

Mrs. HARTZLER. Okay. All right. Well, thank you very much, Mr. Chairman. I appreciate it.

Mr. CONAWAY. The gentlelady yields back. Mr. Hudson for 5 minutes.

Mr. HUDSON. Thank you, Mr. Chairman. As a cosponsor along with my friend from New York, Mr. Maloney, of one of the bills being considered before the House Agriculture Committee, I appreciate the opportunity to hear the testimony of Chairman Gensler and look forward to the testimony of our future panel.

The Swaps Regulatory Improvement Act, H.R. 992, which we introduced on Wednesday last week, along with two bipartisan colleagues in the House Financial Services Committee, amends the provision of the Dodd-Frank Act which sought to prevent risky swaps activities of banks from being eligible for a Federal bailout, FDIC insurance, or capital infusions from the Federal Reserve. While we believe this provision was proposed in good faith, it simply does not prevent the risk that the author has intended.

Moreover, this provision of the bill will cause many American financial institutions to operate at a significant disadvantage to our foreign competitors. Federal Reserve Chairman Ben Bernanke, former Federal Reserve Chairman, Paul Volcker, who was also Chairman of the President's Economic Recovery Advisory Board, and former FDIC Chairman Sheila Bair, have all raised concerns about Section 716. I have with me today letters from the abovementioned financial and economic leaders which illustrate the views on this particular section.

Without objection, Mr. Chairman, I would like to submit them into the record.

Mr. CONAWAY. Without objection they will be submitted.

[The documents referred to are located on p. 117]

Mr. HUDSON. Thank you. I should also point out that 18 Democrats, colleagues from the House Financial Services Committee, including the Ranking Member, Maxine Waters, and former Chairman Barney Frank wrote that they supported the bill that addressed the issues with Section 716 in the last Congress, which is identical to H.R. 992 in this Congress.

I would also like to add that letter for the record, Mr. Chairman.

Mr. CONAWAY. No objection.

[The document referred to is located on p. 121.]

Mr. HUDSON. Just last month on February 26, 2013, Chairman Bernanke testified before the Senate Banking Committee that, "Dodd-Frank is a very big, complicated piece of legislation in an area proving difficult is the push-out provision for derivatives." The next day, February 27, when testifying before the House Financial Service Committee, Chairman Bernanke elaborated on the need for Section 716 reform and stated, "It was not evident that Section 716 makes the company as a whole safer, and what we do see is that it will likely increase costs to people who use the derivatives and make it more difficult for the bank to compete with foreign competitors who can provide a more complete set of services."

Now, Mr. Chairman, I would like to use the balance of my time to ask Chairman Gensler about his concerns with Section 716. Chairman Gensler, I appreciate the opportunity to speak with you today and thank you for your time.

Given the statements from Fed Chairman Bernanke and former Fed Chairman which I provided today, do you agree that Section 716 needs to be reformed?

Mr. GENSLER. I don't have a particular developed view on section 716 partly because it is under the Federal Reserve side, and we have so much we are focused on, and what has happened and what we know. Facts on the ground, 73 registered swap dealers. The vast majority of them are not insured depository institutions. The vast majority are actually affiliates already, which is what they would be if section 716 pushes things out. I would make an observation the vast majority of the swap dealers registered with us in the last 2 months actually are not the banks themselves. Thirty of them are foreign but even amongst the other 45 the majority of those are the affiliates that are ready, and I think section 716 doesn't go into effect for another year or 2, but, again, I am not as close to it.

Mr. HUDSON. Would you consider it an overreach in the authority, or would you categorize it that way? Do you think——

Mr. GENSLER. You mean the original statute? I am sorry.

Mr. HUDSON. Yes, section 716.

Mr. GENSLER. No. I think as I remember it it was a judgment of those who worked on it at the time that certain transactions, energy, and non-interest rate derivatives, as well as certain credit default swaps would be put in the affiliates. The actual facts on the ground are many of these are in affiliates. I think the largest dealers right now, the Goldman Sachs and the Deutsche Banks and so forth do have energy affiliates because that is how they chose to organize themselves, and I could get back to you to look at our list to see how they are organized.

Mr. HUDSON. I appreciate that. You mentioned the international folks. To your knowledge are any international jurisdictions proposed or implemented in any type of swaps, seek push-out provisions similar to this?

Mr. GENSLER. I am not aware of any, sir.

Mr. HUDSON. Okay. As I see my time is dwindling, Mr. Chairman, I will just yield back the balance of my time. Thank you.

Mr. CONAWAY. The gentleman yields back the balance of his time.

We do have a second panel, and I had not intended to a second round of questioning, but with unanimous consent, Mr. Maloney from New York wants one other question, so the gentleman is recognized for 2 minutes.

Mr. MALONEY. Thank you, Mr. Chairman. I will be brief.

Chairman Gensler, I just wanted to ask you, I know you spoke a little bit about the cross-border harmonization efforts that you are engaged in, and I am curious on your view on the status of that. I know you mentioned it before, but I think I may have missed some of what you said, but in particular I am curious about are there areas of dis-harmonization that would create regulatory arbitrage opportunities that worry you?

Mr. GENSLER. There are. We have made tremendous progress with the European Union, Canada, and Japan, and we have other jurisdictions like Australia and Hong Kong, Singapore are always in our—when we meet, when we do these things. Frankly we are further along with Europe particularly.

Where I would raise the greatest policy difference that we just haven't locked in yet is after the transaction and before the transaction in the U.S. the public gets the benefit of some transparency. Europe has that in front of their Parliament right now. I think they are going to do it. It seems to be the consensus to do it, but they are not there yet, and then this other thing is is there are many jurisdictions, whether it is the Cayman Islands or others, that are probably not going to do things. And so that is where, if a U.S. financial institution is guaranteeing their affiliate let's say in the Cayman Islands or something, that risk is going to come right back here. It is going to be unfortunately in our markets, our taxpayers that aren't supposed to stand behind it, but have that risk, and we think that we need to at least say that if it is guaranteed affiliate, we will look to substituted compliance, we will look to home country rules if they are comparable, but if they are not comparable, then it has got to be—we have to look to Dodd-Frank.

Mr. MALONEY. I will yield back, Mr. Chairman.

Mr. CONAWAY. All right. Thank you, Mr. Maloney.

Chairman Gensler, thank you very much. Excellent testimony again. We appreciate it, and thank you and your team for coming to visit with us. We have lots of things to talk about as we move forward and——

Mr. GENSLER. It is truly always an honor to be here, and Member Scott didn't think so, I really do enjoy coming here.

Mr. CONAWAY. Well, thank you. You may need to run for an elected office at some point in time with those skills.

Mr. GENSLER. No, no, no. I won't do that. No. That is for you all.

Mr. CONAWAY. All right. I would now like to introduce our second panel. Thank you, Mr. Gensler.

While they are making their way forward, I will do the introductions. First off we will have Hon. Kenneth E. Bentsen, Acting President and CEO of Securities Industry and Financial Markets Association here in D.C. We have Mr. Jim Colby, Assistant Treasurer, Honeywell International Inc., Morristown, New Jersey. We have Mr. Terrance Naulty, General Manager and CEO of Owensboro Municipal Utilities, Owensboro, Kentucky, on behalf of the American Public Power Association. We have Mr. Larry Thompson, General Counsel, The Depository Trust and Clearing Corporation, New York, New York. We have Ms. Marie Hollein, President and CEO, Financial Executives International and Financial Executives Research Foundation here in Washington on behalf of the Coalition for Derivatives End-Users, and finally, we have Mr. Wallace Turbeville, Senior Fellow, Demos, New York, New York, on behalf of the Americans for Financial Reform.

We got everybody seated, the right name tags up. All right. So, Mr. Bentsen, you are now recognized for 5 minutes at your leisure. Thank you.

STATEMENT OF HON. KENNETH E. BENTSEN, JR., ACTING PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, WASHINGTON, D.C.

Mr. BENTSEN. Thank you, Mr. Chairman and Members of the Committee. I appreciate the opportunity to testify on several important legislative improvements to Title VII of the Dodd-Frank Act that this Committee is considering.

As you know, the Dodd-Frank Act created a broad new regulatory regime for derivative products commonly referred to as swaps. However, if Title VII is implemented incorrectly, it may cause more harm than good. We believe that appropriate sequencing in Title VII rules and coordination is critical to the successful implementation of the Act. In addition, we encourage the regulators to harmonize their rules so that similar products will be subject to similar rules.

I would like to focus my testimony on five specific pieces of legislation that we understand the Committee may take up in the near future.

First, the Swap Push-Out Rule was added to the Dodd-Frank Act at a late stage in the Senate, not debated in the House at all. It would force banks to push out certain swap activities into separately-capitalized affiliates and subsidiaries. As has been mentioned already at this hearing, this provision was opposed at the time and continues to be opposed by then, by Chairman Bernanke of the Federal Reserve, as well as former Chairman of the FDIC Sheila Bair. We believe it would create increased systemic risks and significantly increase costs to banks providing customers with swap products at the expense of those customers.

Last week Congressmen Hultgren and Himes among others introduced bipartisan legislation to modify this provision which we strongly support.

Second, with respect to cross-border, the CFTC and the SEC have not yet finalized rules clarifying their interpretation of which swap activities will be subject to U.S. regulation and which will be subject to foreign regulations. The result has been a significant uncertainty in the international marketplace and due to the CFTC's proposed guidance, a reluctance of foreign market participants to trade with U.S.-registered swap dealers until that uncertainty is resolved.

Last Congress Congressmen Himes and Garrett introduced bipartisan legislation that would provide clarity on this issue, and we understand that the Committee is considering legislation and based upon drafts that we have been informed of, we believe appropriately mandates joint rulemaking as well as providing for coordination on a cross-border basis with our G20 partners.

I would like to mention in addition to that risk of fragmentation that this Committee should be aware of, and that is with respect to the European Union and its recent proposal for what is known as CRD–4, which is the European Union's implementation of Basel III. As proposed by the European Union, this provision would create an exemption under certain Basel III capital calculations for swaps between EU supervised banks and EU non-financial end-users, which would create even further fragmentation on top of that which we see coming out of the CFTC's cross-border guidance, and again, undermine the principles of the G20 of trying to have uniform standards and rules across all jurisdictions.

Third, the Dodd-Frank Act requires a subset of the most standardized swaps to be traded on an exchange or new platform know as swap execution facility. This is something where the CFTC has come out with a proposed rule, yet the SEC has not put out as the SEC, but they are very different in their approach, and in particular, our concern is with the CFTC's proposal to have a minimum mandatory request for quotes that we believe actually undermines the intent of this provision to the detriment of the customers. And in our case, our asset management group and so these are the people that the provision would seek to help, believe that this actually would impede best execution for the benefit of their customers, which include everyday investors, and we think it is appropriate that the Congress take up legislation similar to that which was passed last year by the House Financial Services Committee.

With respect to inter-affiliate swaps, again, this is something where the Act was not clear on. Congressman Stivers has introduced legislation that would clarify inter-affiliate swaps which are a critical part of risk management functions of institutions, and we think the Committee should take that up.

Last, it is critical that regulators carefully balance the benefits of swap-related regulation and the potential decrease in liquidity and increased costs to customers using hedging activities. We think it is appropriate for cost-benefit analysis. In fact, this is consistent with the Obama Administration's Executive Order 13563, which asks agencies to follow similar cost-benefit analysis that Executive Branch agencies and departments already follow under statute. The SEC, I might add, has already weighed into this. We think it is appropriate for the CFTC as well, and we appreciate Congressman Conaway's bill that would bring this into implementation.

With that, Mr. Chairman, I appreciate the opportunity to testify on behalf of our members at SIFMA, and I am happy to answer your questions at the appropriate time.

[The prepared statement of Mr. Bentsen follows:]

PREPARED STATEMENT OF HON. KENNETH E. BENTSEN, JR., ACTING PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, WASHINGTON, D.C.

Chairman Lucas and Ranking Member Peterson. My name is Ken Bentsen and I am Acting President and CEO of the Securities Industry and Financial Markets Association (SIFMA).[1] SIFMA appreciates the opportunity to testify on several important legislative improvements to Title VII of the Dodd-Frank Act relating to derivatives being considered by the House of Representatives.

As you know, the Dodd-Frank Act created a new regulatory regime for derivative products commonly referred to as swaps. Dodd-Frank seeks to reduce systemic risk by mandating central clearing for standardized swaps through clearinghouses. capital requirements and collection of margin for uncleared swaps; to protect customers through business conduct requirements; and to promote transparency through reporting requirements and required trading of swaps on exchanges or swap execution facilities. SIFMA supports these goals. There have been significant and constructive reforms put in place that market participants have implemented. Late last year, firms engaged in significant swap dealing activities were required to register with the CFTC as swap dealers and became subject to reporting, record-keeping and other requirements, many more of which will be phased in over time. This week, the first swap transactions were required to be cleared at central clearinghouses to decrease systemic risk in the swap markets. These accomplishments will make our system safer, and it is important that market participants realize that these changes represent real progress.

However, as with all regulation, if Title VII is implemented incorrectly it may cause more harm than good. Specifically, incorrect implementation of Title VII has the potential to detrimentally limit the availability and increase the cost of derivatives, which are a valuable risk management tool for American businesses, including manufacturers and the agricultural industry.

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

We recognize the tremendous undertaking required by regulators in their efforts to implement derivatives reform. Throughout this process, SIFMA has sought to constructively engage with regulators through the comment process.

As an overarching matter, I want to emphasize our belief that appropriate sequencing of Title VII rules and coordination between the various regulators responsible for them is critical to successful implementation of the Dodd-Frank Act. In order to adapt to the new swap regulatory regime, our member firms are making dramatic changes to their business, operational, legal and compliance systems. We continue to work closely with the relevant regulators on developing an appropriate implementation timeline to avoid a rushed process that would raise unnecessary complications and risk. In addition, we encourage the regulators to harmonize their rules so that similar products will be subject to similar rules.[2]

In the remainder of my testimony, I would like to focus on a few specific issues that are the topic of legislation currently pending before this Committee, which could have a profound impact on the success of Title VII and its impact on the marketplace.

The Swap Push-Out Rule

The first important initiative I would like to highlight is legislation to amend Section 716 of the Dodd-Frank Act, often referred to as the "Swap Push-Out Rule." The Swap Push-Out Rule was added to the Dodd-Frank Act at a late stage in the Senate and was not debated or considered in the House of Representatives. It would force banks to "push out" certain swap activities into separately capitalized affiliates or subsidiaries by providing that a bank that engages in such swap activity would forfeit its right the Federal Reserve discount window or FDIC insurance.

The Swap Push-Out Rule has been opposed by senior Prudential Regulators from the time it was first considered. Ben Bernanke, Chairman of the Federal Reserve, stated in a letter to Congress that "forcing these activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities."[3] Sheila Bair, former FDIC Chairwoman, said that "by concentrating the activity in an affiliate of the insured bank, we could end up with less and lower quality capital, less information and oversight for the FDIC, and potentially less support for the insured bank in a time of crisis" and added that "one unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund."[4]

In addition to the increase in risk that would be caused by the Swaps Push-Out Rule, the limitations will significantly increase the cost to banks of providing customers with swap products as a result of the need to fragment related activities across different legal entities. As a result, U.S. corporate end-users and farmers will face higher prices for the instruments they need to hedge the risks of the items they produce.[5] Mark Zandi, Chief Economist at Moody's Analytics, stated in a letter to Congressman Garrett that "Section 716 would create significant complications and counter the efforts to resolve [large financial] firms in an orderly manner."[6]

Last Congress, Congresswoman Nan Hayworth introduced H.R. 1838, (*http://www.gpo.gov/fdsys/pkg/BILLS-112hr1838ih/pdf/BILLS-112hr1838ih.pdf*) legisla-

[2] SIFMA/ISDA Comments to CFTC on Proposed Schedule for Title VII Rulemaking (June 29, 2012), *http://www.sifma.org/issues/item.aspx?id=8589939400;* SIFMA Comments to SEC on the Sequencing of Compliance Dates for Security-Based Swap Final Rules (Aug. 13, 2012), *http://www.sifma.org/issues/item.aspx?id=8589939893.*

[3] Letter from Ben Bernanke, Federal Reserve Chairman, to Senator Christopher Dodd (May 13, 2010), available at *http://blogs.wsj.com/economics/2010/05/13/bernanke-letter-to-lawmakers-on-swaps-spin-off/.*

[4] Letter from Sheila Bair, FDIC Chairman, to Senators Christopher Dodd and Blanche Lincoln (Apr. 30, 2010), available at *http://www.gpo.gov/fdsys/pkg/CREC-2010-05-04/pdf/CREC-2010-05-04-pt1-PgS3065-2.pdf#page=5.*

[5] An example of negative impacts of the "Swap Push-Out Rule" can be seen when a mid-size agriculture producer ("Ag Producer") receives a revolver loan with a floating rate of interest from a bank. In order to hedge the interest rate exposure, the Ag Producer executes a master swap agreement with the Bank and executes a fixed-for-floating interest rate swap as a hedge ("Interest Rate Hedge"). The Ag Producer's risk management guidelines require it to hedge the price exposure related to its production of wheat by executing a wheat swap ("Wheat Hedge"). Under the Push-Out Rule, the bank would not be able to execute the wheat swap with the Ag Producer. With this restriction, the Ag Producer would be required to negotiate another master swap agreement with an affiliate of the bank or a third party and then execute the wheat swap with such entity. With separate entities as hedging counterparties, there is no netting of the Wheat Hedge and the Interest Rate Hedge. Without the efficiency of netting, the Ag Producer's gross exposure to both entities would be used to calculate its exposure and margin requirements.

[6] Letter from Mark Zandi, Chief Economist, Moody's Corporation, to Congressman Scott Garrett (Nov. 14, 2011).

tion that would strike Section 716 from the Dodd Frank Act. The House Financial Services Committee considered and made significant changes to this bill. The first change was to modify this bill so that additional types of products could remain within the bank. This bill also included an important provision for foreign institutions. SIFMA supported both of these changes and submitted a letter of support for this bill.[7]

Last week, Congressman Hultgren introduced bipartisan legislation (H.R. 992) (*http://www.gpo.gov/fdsys/pkg/BILLS-113hr992ih/pdf/BILLS-113hr992ih.pdf*) that would, in his words, "modify the 'push-out' provision in the Dodd-Frank Act to ensure that federally insured financial institutions can continue to conduct risk-mitigation efforts for clients like farmers and manufacturers that use swaps to insure against price fluctuations."[8] SIFMA applauds Congressman Hultgren for this critical legislation and urges the House Committee on Agriculture to favorably report this bill.

Cross-Border Impact of Dodd-Frank

Though Title VII was signed into law 2½ years ago, we still do not know which swaps activities will be subject to U.S. regulation and which will be subject to foreign regulation. Section 722 of the Dodd-Frank Act limits the CFTC's jurisdiction over swap transactions outside of the United States to those that "have a direct and significant connection with activities in, or effect on, commerce of the U.S." or are meant to evade Dodd-Frank. Section 772 limits the SEC's jurisdiction over security-based swap transactions outside of the United States to those meant to evade Dodd-Frank. However, the CFTC and SEC have not yet finalized (or, in the SEC's case, proposed) rules clarifying their interpretation of these statutory provisions. The result has been significant uncertainty in the international marketplace and, due to the aggressive position being taken by the CFTC as described below, a reluctance of foreign market participants to trade with U.S. financial institutions until that uncertainty is resolved.

While the CFTC has proposed guidance on the cross-border impact of their swaps rules, that guidance inappropriately recasts the restriction that Congress placed on CFTC jurisdiction over swap transactions outside the United States into a grant of authority to regulate cross-border trades. The CFTC primarily does so with a very broad definition of "U.S. Person," which it applies to persons with even a minimal jurisdictional nexus to the United States. In addition, the CFTC has released several differing interim and proposed definitions of "U.S. Person" for varying purposes, resulting in a great deal of ambiguity and confusion for market participants. SIFMA supports a final definition of U.S. Person that focuses on real, rather than nominal, connections to the United States and that is simple, objective and determinable so a person can determine its status and the status of its counterparties.[9] Equally significant, the CFTC has issued its proposed cross-border release as "guidance" rather than as formal rulemaking process subject to the Administrative Procedure Act. By doing so, the CFTC avoids the need to conduct a cost-benefit analysis, which is critical for ensuring that the CFTC appropriately weighs any costs imposed on market participants as a result of implementing an overly broad and complex U.S. person definition against perceived benefits.

The SEC has not yet proposed cross-border rules. The Commission and its staff have publicly suggested, however, that they will consider a holistic cross-border rule proposal later this year. It is rumored that this document will be nearly 1,000 pages long and will include many questions for public comment.

Last Congress, Congressmen Himes and Garrett introduced bipartisan legislation (H.R. 3283) (*http://www.gpo.gov/fdsys/pkg/BILLS-112hr3283ih/pdf/BILLS-112hr3283ih.pdf*) that would provide clarity on this issue. The Himes-Garrett bill would permit non-U.S. swap dealers to comply with capital rules in their home jurisdiction that are comparable to U.S. capital rules and adhere to Basel standards. The legislation also prevents the requirement that registered swap dealers post separate margins for each jurisdiction under which they are regulated. During the 112th Congress, the House Financial Services Committee acted to support this legislation by a vote of 41 to 18. SIFMA strongly supports this effort to clarify the juris-

[7] *http://www.sifma.org/workarea/downloadasset.aspx?id=8589937400.*

[8] In addition, the bill would fix a drafting error acknowledged by the Swap Push-Out Rule's authors, under which the limited exceptions to the rule that apply to insured depositing institutions appear not to include U.S. uninsured branches or agencies of foreign banks.

[9] SIFMA Comments to CFTC Proposed Interpretive Guidance (August 27, 2013), available at *http://www.sifma.org/issues/item.aspx?id=8589940053;* SIFMA/TCH/FSR Comments to CFTC on Further Proposed Guidance (Feb. 6. 2013), available at *http://www.sifma.org/issues/item.aspx?id=8589941955.*

diction of U.S. regulators and urges the House Agriculture Committee to vote for this critical legislation.

Swap Execution Facilities

As I noted above, the Dodd-Frank Act requires a subset of the most standardized swaps to be traded on an exchange or a new platform known as a "swap execution facility," commonly called a "SEF." Congress generally defined what constitutes a SEF but left further definition to the CFTC and SEC. To date, both the CFTC and SEC have proposed SEF definitions for the products under their respective jurisdiction, but neither Commission has adopted a final definition.

An appropriately flexible definition of "SEF" is critical for ensuring that SEF trading requirement does not negatively impact liquidity in the swap markets. In truth, it remains unclear what will happen to liquidity of instruments that have been traditionally transacted bilaterally when they are subjected to a SEF environment. Understanding this reality, the SEC has proposed a rule that would permit SEFs to naturally evolve their execution mechanisms for those swaps that are widely traded. These SEFs could be structured in many different ways, similar to how electronic trading platforms have evolved in the securities markets.

The CFTC has proposed a different rule that would require customers to either trade swaps on SEFs as if they were traded on exchanges or to solicit prices by issuing requests for quotes, generally known as "RFQs," from a minimum of five market participants for each swap subject to the SEF trading requirement. This differs from current market practice and could have significant impact on the liquidity in the swap market. By signaling to the market the desire to purchase a swap, customers may be telegraphing important information that may impede best execution of their orders. While we appreciate the CFTC's goals of encouraging competition among dealers to decrease the price of swaps, the reality is that this practice will do just the opposite and drive up the cost of transactions, ultimately harming the corporations and other swaps users this rule aims to protect.

Last Congress, the House Financial Services Committee supported, by voice vote, legislation that would require CFTC and the SEC to adopt SEF rules that allow the swaps markets to naturally evolve to the best form of execution (H.R. 2586) (*http://www.gpo.gov/fdsys/pkg/BILLS-112hr2586rh/pdf/BILLS-112hr2586rh.pdf*). H.R. 2586 would explicitly not require a minimum number of participants to receive or respond to quote requests and would prevent regulators from requiring SEFs to display quotes for any period of time. Finally, this bill would prevent regulators from limiting the means by which these contracts should be executed and ensuring that the final regulation does not require trading systems to interact with each other. SIFMA urges Congress to support similar legislation in this Congress.

Inter-Affiliate Swaps

The Dodd-Frank Act is effectively silent on the application of swap rules to swaps entered into between affiliates. Such inter-affiliate swaps provide important benefits to corporate groups by enabling centralized management of market, liquidity, capital and other risks inherent in their businesses and allowing these groups to realize hedging efficiencies. Since the swaps are between affiliates, rather than with external counterparties, they pose no systemic risk and therefore there are no significant gains to be achieved by requiring them to be cleared or subjecting them to margin posting requirements. In addition, these swaps are not market transactions and, as a result, requiring market participants to report them or trade them on an exchange or swap execution facility provides no transparency benefits to the market—if anything, it would introduce useless noise that would make Dodd-Frank's transparency rules less helpful.

During the 112th Congress, the House of Representatives voted 357 to 36 in support of legislation (H.R. 2779) (*http://www.gpo.gov/fdsys/pkg/BILLS-112hr2779pcs/pdf/BILLS-112hr2779pcs.pdf*) that would exempt inter-affiliate trades from certain Title VII requirements due to the important role the transactions play in firms' risk management procedures and the negative impact the full scope of Title VII regulation would have if applied to them. In this Congress, Congressman Stivers has introduced H.R. 677 (*http://www.gpo.gov/fdsys/pkg/BILLS-113hr677ih/pdf/BILLS-113hr677ih.pdf*), the Inter-Affiliate Swap Clarification Act, which would exempt certain inter-affiliate transactions from the margin, clearing, and reporting requirements under Title VII. SIFMA supports this initiative and urges the House Committee on Agriculture to vote in support of this important bill.

Cost-Benefit Analysis

As noted above, it is critical that regulators carefully balance the benefits of swap-related regulation with the potential decreases in liquidity and increased costs to customers wishing to hedge their activities. As a result, throughout the Title VII rulemaking process, SIFMA has encouraged regulators to conduct comprehensive cost-benefit analysis for all Dodd-Frank rules.

This is consistent with the Obama Administration's efforts to promote better cost-benefit analysis for Federal agencies through Executive Order 13563,[10] which requires all agencies proposing or adopting regulations to include cost-benefit analyses in an attempt to minimize burdens, maximize net benefits and specify performance objectives. The President also stated that regulations should be subject to meaningful public comment, be harmonized across agencies, ensure objectivity and be subject to periodic review. In 2012, in testimony before the House Committee on Government Reform, SEC Chairman Schapiro stated "I continue to be committed to ensuring that the Commission engages in sound, robust economic analysis in its rulemaking, in furtherance of the Commission's statutory mission, and will continue to work to enhance both the process and substance of that analysis." [11]

Congressman Conaway has introduced legislation (H.R. 1003) that would require the CFTC's cost-benefit analysis to be both quantitative and qualitative and specifies in greater detail the costs and benefits that the CFTC must take into account as part of their cost-benefit analyses. The bill also requires that a regulation adopted by the CFTC must "measure, and seek to improve, the actual results of regulatory requirements." SIFMA strongly supports H.R. 1003 and urges the House Committee on Agriculture to support this vital initiative that would enhance cost-benefit analysis done by the CFTC.

Thank you for giving me this opportunity to explain our views related to several important measures to be considered by the House Committee on Agriculture.

The CHAIRMAN. Thank you, Mr. Bentsen.

You may proceed when you are ready, Mr. Colby.

STATEMENT OF JAMES E. COLBY, ASSISTANT TREASURER, HONEYWELL INTERNATIONAL INC., MORRISTOWN, NJ

Mr. COLBY. Mr. Chairman, Ranking Member Peterson, and other Members of the Committee, thank you for inviting me to testify at this important hearing. I am an Assistant Treasurer at Honeywell International, and today I speak on behalf of Honeywell and other commercial end-users, including members of the Coalition for Derivatives End-Users.

Honeywell is a diversified technology and manufacturing leader serving customers worldwide with aerospace products and services, control technologies for buildings, homes, and industry, turbochargers, and performance materials. Honeywell's growth is driven by technologies that address some of the world's toughest challenges such as energy efficiency, clean energy generation, safety and security, globalization, and customer productivity.

Honeywell is truly a global company with more than 50 percent of our sales outside of the United States, and we are, therefore, exposed to market risks from changes in interest rates, foreign exchange rates, and commodity prices. When appropriate, we hedge exposures through the use of derivative contracts. The purpose of our hedging activities is to eliminate risks that we cannot control, allowing us to focus on our core strengths, namely delivering high-quality products to our customers. We do not use derivatives for speculative purposes.

I will provide some examples to demonstrate how we use derivatives. We sell satellite and launch vehicle inertial measurement units manufactured in Florida to customers in Germany. Europe is a key growth market for commercial space products, and in order to qualify for consideration on certain opportunities, we may be re-

[10] *http://www.whitehouse.gov/the-press-office/2011/01/18/improving-regulation-and-regulatory-review-executive-order*.

[11] *http://www.sec.gov/news/testimony/2012/ts041712mls.htm*.

quired to enter into contracts denominated in Euros, even though all costs of production are incurred in U.S. dollars. The period for this type of contract can span multiple years during which changes in the value of the Euro *versus* the U.S. dollar can significantly impact its economic viability. To mitigate this risk we may enter into a forward contract to sell an amount of Euros equal to our net exposure to lock in the market rate.

Honeywell sells catalysts and adsorbents manufactured in multiple U.S. manufacturing plants to customers in the refining industry. As the refinery starts up, a supply of catalysts is required to operate it, and Honeywell could arrange a catalyst supply agreement with the customer as part of the overall package. During contract negotiations, some European customers will require sales contracts to be denominated in Euros whereas all costs of production are incurred in U.S. dollars. To mitigate this risk, Honeywell may enter into a forward contract to sell an amount of Euros equal to our net exposure to lock in the market rate.

Honeywell carefully manages its ratio of fixed to floating-rate debt in order to lower its overall cost of debt while providing sufficient interest rate certainty to accurately forecast and manage interest expense. Floating-rate debt has historically been cheaper than fixed-rate debt but cannot be easily issued in longer maturities, thereby exposing Honeywell to refinancing risks. Honeywell uses interest rate derivatives to convert a portion of its fixed-rate debt to floating, thereby creating a synthetic floating-rate note with a longer term maturity that can be issued directly in the capital markets.

With compliance deadlines looming, Honeywell is concerned with the direction in which certain rules appear to be heading. We strongly support two bills referred to your Committee. H.R. 634 would exempt transactions in which a non-financial end-user is a party from margin requirements, whereas H.R. 677 would exempt inter-affiliate transactions of end-users from clearing requirements.

The margin bill is of particular interest to Honeywell. In the Dodd-Frank Act Congress made clear that end-users were not to be subject to margin requirements. Nonetheless, regulations proposed by the Prudential Banking Regulators could require end-users to post margin. This stems directly from what they view to be a legal obligation under Title VII. While the regulations proposed by the CFTC are preferable, they do not provide end-users with the certainty that legislation offers. According to a Coalition for Derivatives End-Users' survey, a three percent initial margin requirement could reduce capital spending by as much as $5.1 to $6.7 billion among S&P 500 companies alone and cost 100,000 to 130,000 jobs.

What does this mean for Honeywell? We had approximately $2 billion of hedging contracts outstanding at year end that would be defined as a swap under Dodd-Frank. Applying the three percent initial margin and ten percent variation margin implies a potential margin requirement of $260 million. Cash deposited in a margin account cannot be productively deployed in our business, and therefore, detracts from Honeywell's financial performance and the ability to promote economic growth and protect American jobs.

The margin bill does not undermine Dodd-Frank. It helps ensure that the final Act and rules function as intended and that commercial end-users do not face the same regulatory burden as those who speculate and create systemic risk. Not only did commercial end-users not contribute to the financial crisis, but they were a safe haven during the financial turmoil. Investors who were afraid to invest in the debt of financial institutions purchased the debt of companies like Honeywell, companies that prudently use derivatives to manage and reduce risk and to manage the financial crisis without need for government assistance.

In conclusion, we need Congress to enact legislation so that end-users like Honeywell will continue to have the ability to manage risks without having margin requirements imposed on us.

Thank you for inviting me to testify today. We greatly appreciate the support that the Committee has provided, and I look forward to answering any questions that you may have.

[The prepared statement of Mr. Colby follows:]

PREPARED STATEMENT OF JAMES E. COLBY, ASSISTANT TREASURER, HONEYWELL INTERNATIONAL INC., MORRISTOWN, NJ

Mr. Chairman, Ranking Member Peterson, and other Members of the Committee, thank you for inviting me to testify at this important hearing. I am an Assistant Treasurer at Honeywell International and today I speak on behalf of both Honeywell and commercial end-users.

Honeywell is a diversified technology and manufacturing leader, serving customers worldwide with aerospace products and services; control technologies for buildings, homes and industry; turbochargers; and performance materials. Honeywell's growth is driven by technologies that address some of the world's toughest challenges such as energy efficiency, clean energy generation, safety & security, globalization and customer productivity. The company's more than 132,000 employees include 20,000 scientists and engineers who are focused on developing innovative products and solutions that help Honeywell's customers—and their customers—improve performance and productivity.

Honeywell is truly a global company, with more than 50 percent of our sales outside of the United States and we are therefore exposed to market risks from changes in interest rates, foreign exchange rates and commodity prices. When appropriate, we hedge exposures through the use of derivative contracts. The purpose of our hedging activities is to eliminate risks that we cannot control, allowing us to focus on our core strengths, namely delivering high-quality products, on time, to our customers in a manner that not only meets, but exceeds expectations. We do not use derivatives for speculative purposes.

I'll provide some examples to demonstrate how we use derivatives. We sell satellite and launch vehicle inertial measurement units manufactured in Florida to customers in Germany. Europe is a key growth market for commercial space products and, in order to qualify for consideration on certain opportunities, we may be required to enter into contracts denominated in Euros even though all costs of production are incurred in U.S. Dollars. The period for this type of contract can span multiple years, during which changes in the value of the Euro *versus* the U.S. dollar can significantly impact its economic viability. To mitigate this risk, we may enter into a forward contract to sell an amount of Euros equal to our net exposure to lock in the market rate.

Honeywell sells catalysts and adsorbents manufactured in multiple U.S. manufacturing plants to customers in the refining industry. As a refinery starts-up, a supply of catalysts is required to operate it and Honeywell will attempt to arrange a Catalyst Supply Agreement with the customer as part of the overall package. During contract negotiations, some European customers will require sales contracts to be denominated in Euros, whereas all costs of production are incurred in U.S. Dollars. To mitigate this risk, Honeywell may enter into a forward contract to sell an amount of Euros equal to our net exposure to lock in the market rate.

Honeywell carefully manages its ratio of fixed-to floating rate debt in order to lower its overall cost of debt, while providing sufficient interest rate certainty to accurately forecast and manage interest expense. Floating rate debt has historically been cheaper than fixed-rate debt, but cannot be easily issued in longer maturities, thereby exposing Honeywell to refinancing risk. Honeywell uses interest rate derivatives to convert a portion of its fixed-rate debt to floating, thereby creating a synthetic floating rate note with a longer-term maturity than can be issued directly in the capital markets.

With compliance deadlines for end-users looming, Honeywell is concerned with the direction in which certain rules appear to be heading. We strongly support two pieces of legislation that have been referred to your Committee. H.R. 634 would exempt transactions in which a non-financial end-user is a party from margin requirements, whereas H.R. 677 would exempt inter-affiliate transactions of end-users from clearing requirements.

Today I will focus on the margin bill, as it is of particular interest to Honeywell. In approving the Dodd-Frank Act, Congress made clear that end-users were not to be subject to margin requirements. Nonetheless, regulations proposed by the Prudential Banking Regulators could require end-users to post margin. This stems directly from what they view to be a legal obligation under Title VII. While the regulations proposed by the CFTC are preferable, they do not provide end-users with the certainty that legislation offers. According to a Coalition for Derivatives End-Users survey, a 3% initial margin requirement could reduce capital spending by as much as $5.1 to $6.7 billion among S&P 500 companies alone and cost 100,000 to 130,000 jobs.

To shed some light on Honeywell's potential exposure to margin requirements, we had approximately $2 billion of hedging contracts outstanding at year-end that would be defined as a swap under Dodd-Frank. Applying 3% initial margin and 10% variation margin implies a potential margin requirement of $260 million. Cash deposited in a margin account cannot be productively deployed in our businesses and therefore detracts from Honeywell's financial performance and ability to promote economic growth and protect American jobs.

The following is an excerpt of a question and answer session on July 17, 2012 between Senator Mike Crapo and Federal Reserve Board Chairman Ben Bernanke at the Hearing of the Senate Banking, Housing and Urban Affairs: "The Semiannual Federal Reserve Monetary Policy Report to the Congress." This dialogue underscores why a Margin bill is necessary.

> Senator CRAPO: "According to the proposed rule, the proposal to require margins stems directly from what they view to be a legal obligation under Title VII. Recently I offered an amendment with Senator Johanns to fulfill Congressional intent by providing an explicit exemption for margin requirements for non-financial end-users that qualify for the clearing exemption. The amendment is identical to the House bill which passed the House by a vote of 370 to 24."
>
> "Is it accurate in your opinion, that regardless of Congressional intent, the banking regulators view the plain language of the statute as requiring them to impose some kind of margin requirement on non-financial end-users unless Congress changes the statute?"
>
> Chairman BERNANKE: "We believe that the statute does require us to impose some type of margin requirement. We tried to mitigate the effect as much as possible by allowing for exemptions when the credit risk associated with the margin was viewed as being sufficiently small. So many small end-users would be exempt in practice."
>
> Senator CRAPO: "Do you agree that the non-financial end-users hedging does not contribute to systemic risk, that the economy, the economic benefits from their risk management activity—excuse me—that the economy benefits from their hedging activity and that it's appropriate for Congress to provide an explicit exemption for margin requirements for non-financial end-users that qualify for the clearing exemption?"
>
> Chairman BERNANKE: "I certainly agree that non-financial end-users benefit and that the economy benefits from the use of—of derivatives. It seems to be the sense of a large portion of the Congress that that exemption should be made explicit. And speaking for the Federal Reserve, we're very comfortable with that proposal."

We are not interested in dismantling Dodd-Frank. We are simply trying to ensure that the final Act and rules function as intended and that commercial end-users do not face the same regulatory burden as those who speculate and create systemic risk. Not only did commercial end-users not contribute to the financial crisis, but they were a safe-haven during the financial turmoil. Investors who were afraid to invest in the debt of financial institutions were actively purchasing the debt of companies like Honeywell, companies that prudently use derivatives to manage and reduce risk and who continued to be profitable throughout the financial crisis, with no need for government assistance.

In conclusion, we need Congress to enact legislation so that end-users like Honeywell will continue to have the ability to manage risk without having margin requirements imposed on us.

Thank you for inviting me to testify today. We greatly appreciate the support that the Committee has provided and I look forward to answering any questions that you may have.

The CHAIRMAN. Thank you, Mr. Colby.

Mr. Naulty, you may begin when you are ready.

STATEMENT OF TERRANCE P. NAULTY, GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER, OWENSBORO MUNICIPAL UTILITIES; MEMBER, AMERICAN PUBLIC POWER ASSOCIATION, OWENSBORO, KY

Mr. NAULTY. Good morning, Mr. Chairman, Members of the Committee. My name is Terrance Naulty. I am the General Manager and CEO of Owensboro Municipal Utilities. Prior to this position I spent 15 years in senior management at utility-affiliated trading companies and at a financial entity.

I thank you for the opportunity to testify today on behalf of the American Public Power Association of which we are a member. OMU provides water and telecommunications and electric services to over 26,000 customers in Owensboro, the third largest city in Kentucky. We operate a 540 megawatt coal-fired power plant that produces some of the lowest cost power in the Midwest and Southeast. Approximately 63 percent of our electric revenues are derived from the wholesale market.

Traditionally we have hedged future wholesale electric revenues with bilateral fixed-for-floating swaps at liquid trading points that are in close proximity to the point of physical delivery. These swaps hedge future wholesale revenue and consequently protect our customer owners from the wholesale price fluctuations associated with both long-term and short-term market movements. By hedging this future revenue stream we can ensure stable and low electric rates.

To limit our credit risks and reduce costs we would enter into financial swap transactions with the most active and credit-worthy counterparties in the physical markets we sell into. Most of these counterparties are affiliates of investor-owned utilities. We also have limited enabling agreements with financial entities. With these financial entities and more importantly the utility-affiliated trading counterparties, OMU is able to hedge its position with virtually no cash reserve requirements due to the strength of our balance sheet.

However, CFTC regulations implementing the Dodd-Frank Act have made this pragmatic and conservative hedging strategy very difficult. Under the regulations our non-swap dealer counterparties can engage in just $25 million per year in swap dealing activities with government-owned utilities and other special entities before being classified as a swap dealer.

Even OMU's relatively small hedge position has an notional value in excess of $200 million. Also, the comparable limit for swap-dealing activities with other non-governmental entities is $8 billion. As a result, two of our three largest trading counterparties informed us that they would no longer transact financial swaps with us for fear of becoming a swap dealer under the Act. This decision has forced us to change our risk management strategy in two ways.

First, we can now only use financial entities willing to register as a swap dealer. Our hedging transactions have migrated from utility-affiliated companies to these financial entities, and we have seen the bid-ask spreads widen.

Second, to avoid these wider spreads and define liquidity where we hedge, we have been forced to the ICE and IMEX trade platforms to manage our position. Both these futures platforms require cash reserves to meet initial and maintenance margin. This means OMU can no longer take advantage of its negotiated collateral arrangements. As a result, our Board of Directors has required us to establish incremental reserves of $10 million to ensure that the utility can meet margin calls associated with its hedge position. If this $10 million in incremental cash reserves were funded from our customers, the result would be approximately ten percent rate increase.

The CFTC in October provided a no-action letter which we heard about this morning that moved the threshold from $25 million to $800 million. However, the letter has imposed a number of new and additional requirements, and as a result, the position of our lost trading counterparties has not changed.

In response just this Monday H.R. 1038, the Public Power Risk Management Act of 2013, was introduced. The legislation provides narrow targeted relief for utility operations related to swaps for government-owned entities. The legislation carefully defines which entity would qualify as a utility special entity and the types of swaps that could and could not be considered a utility operations-related swap.

In conclusion, the protection that CFTC is trying to afford through the $25 million special entity sub-threshold are not needed for government-owned utilities. We are well versed in the markets and rely on these swaps solely to manage the price and operational risks. A failure to allow the narrow exclusion provided under this Public Power Risk Management Act will limit our members' ability to hedge against risks and lead to higher costs for the customers they serve.

Thank you again for the opportunity to testify.

[The prepared statement of Mr. Naulty follows:]

PREPARED STATEMENT OF TERRANCE P. NAULTY, GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER, OWENSBORO MUNICIPAL UTILITIES; MEMBER, AMERICAN PUBLIC POWER ASSOCIATION, OWENSBORO, KY

Mr. Chairman and Members of the Committee, I am Terry Naulty, General Manager and CEO of Owensboro Municipal Utilities (OMU) testifying today on behalf of my utility and the American Public Power Association (APPA).[1]

OMU is located in Owensboro, Kentucky, proudly serving an estimated 26,100 electric customers and 24,739 water users, including both residential and commercial accounts. The sole purpose of our business is to ensure that the electric and water and sewer demands of our customers are met, both today and for generations to come.

OMU is a member of APPA, the national service organization representing the interests of over 2,000 municipal and other state- and locally-owned, not-for-profit

[1] "Public Power" is not defined in the law, but generally refers to government-owned utilities. This is distinguished from a "public utility" which generally refers to an investor-owned utility, as under the Public Utility Holding Company Act of 1935 and the Federal Power Act.

electric utilities throughout the United States (all but Hawaii). Collectively, these government-owned utilities deliver electricity to one of every seven electricity customers in the United States (approximately 47 million people), serving some of the nation's largest cities. However, the vast majority of APPA's members serve communities with populations of 10,000 people or less.

I appear today to speak in favor of H.R. 1038, the Public Power Risk Management Act of 2013, legislation that will allow my utility, and other government-owned power and natural gas utilities, to hedge against price risks on a level playing field with all other utilities. This legislation will protect our customers from unnecessary price increases.

Public Power Utilities and the Dodd-Frank Act

In the wake of the 2007 and 2008 Financial Crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) required the Commodity Futures Trading Commission (CFTC) to provide comprehensive regulations for the swaps marketplace. Specifically, the Dodd-Frank Act requires swap dealers and major swap participants to register with the CFTC and meet capital, margin, and reporting and record-keeping requirements, as well as to comply with rigorous business conduct and documentation standards.

The Dodd-Frank Act provides additional standards for swap dealers or major swap participants advising or entering into swaps with government-owned utilities and other government entities (referred to under the statute as "special entities"). For a swap dealer acting as an advisor to a special entity, the law states that the swap dealer shall have a duty to act in the best interests of the special entity.[2] For swap dealers or major swap participants entering into swaps with special entities, the law states that these dealers and swap participants must comply with rules set by the CFTC requiring special entities to have a qualified independent representative before trading with a swap dealer or major swap participant.[3]

Also, in part to address concerns that the legislation would force too many entities into this more stringent regime, the Dodd-Frank Act included a "*de minimis* exception" to the definition of a swap dealer.[4]

APPA supports the goals of the Dodd-Frank Act and has worked closely with the CFTC and other interested parties to improve its implementation, particularly related to regulations affecting "end-users"—that is, non-financial parties that enter into swaps to hedge or mitigate their commercial risks. OMU and other APPA members are "end-users." Dozens of new regulations affect our members' businesses, and APPA and a coalition of not-for-profit electric utilities have submitted formal comments on 17 specific regulations from the CFTC and Securities and Exchange Commission (SEC) related to implementation of the Dodd-Frank Act.

One such instance is the rule defining swap-dealer,[5] which became final on July 23, 2012. Swap dealer registration regulations went into effect on October 12, 2012, at which time entities were required to begin counting their "swap dealing" activities. Those with dealing activity in excess of the *de minimis* thresholds had to register as swap dealers by December 31, 2012. However, the CFTC issued several no-action letters that allow swap dealers to delay their compliance with most of the business conduct and documentation standards until July 2013.

As written, the swap-dealer definition will substantially hinder government-owned utilities' ability to hedge against operational risks. Just like OMU, these utilities have no shareholders, so the costs imposed by this regulatory decision will be borne by only one group: our residential and business customers.

In December 2010, the CFTC jointly with the SEC issued a proposed rule to define the term "swap dealer," including (as required by the statute) an exception from the swap-dealer designation for those entities that engage in a *de minimis* quantity of swap dealing.

In the proposed rule, the CFTC proposed two separate *de minimis* thresholds relating to the dollar quantity of swaps: $100 million annually for an entity's total swap-dealing activity; and, $25 million annually for an entity's swap-dealing activity with special entities, including, as noted above, public power, public gas, and Federal utilities (government-owned utilities).

In February 2011, the Not-For-Profit Electric End User Group (NFP EEU)—which includes APPA—filed comments on the proposed swap dealer rule. The comments recommended that the CFTC substantially increase the *de minimis* threshold both for total swaps and for swaps with special entities.

[2] 7 U.S.C. § 6s(h)(4).
[3] 7 U.S.C. § 6s(h)(5).
[4] 7 U.S.C. § 1a(49)(D).
[5] CFTC Regulation 1.3(ggg)(4); see 77 *Fed. Reg.* 30596, at 30744.

A final swap dealer rule was approved by the CFTC on April 18, 2012, and was published in the *Federal Register* on May 23, 2012. The final rule greatly increased the overall *de minimis* threshold from the proposed rule, raising it from $100 million to $3 billion. During an initial phase-in period, this threshold will be $8 billion. But, the final rule did not change the proposed rule's $25 million sub-threshold for swap-dealing activities with special entities. Thus, the disparity between the two thresholds is now substantially greater. This $25 million sub-threshold is smaller still when you consider that it is the aggregate of a swap partner's transactions with all special entities during any 12 month period.[6]

As a result, non-financial entities (such as natural gas producers, independent generators, and investor-owned utility companies) that do not want to be swap dealers will severely limit their swap-dealing activities with government-owned utilities to avoid exceeding the $25 million threshold.

Why Hedging Is Necessary

Government-owned utilities depend on non-financial commodity transactions, trade options, and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations, and public service obligations. Together, non-financial commodity markets play a central role in the ability of government-owned utilities to secure electric energy, fuel for generation, and natural gas supplies for delivery to consumers at reasonable and stable prices.

Specifically, many government-owned utilities purchase firm electric energy, fuel and natural gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially-settled non-financial commodity swaps with customized terms to hedge the unique operational risks to which many government-owned utilities are subject. Additionally, many government-owned utilities have traditionally used the swaps and futures products to hedge their excess electrical generation capacity, thus providing revenue and rate certainty to their customer/owners. In hedging, mitigating or managing the commercial risks of their utility facilities' operations or public service obligations, government-owned utilities are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

Why Non-Financial Counterparties Are Necessary

Electric power touches virtually every home and business in the United States. This near universality gives a false appearance of homogeneity. It is important to remember that what is being delivered, either power or fuel to provide power, is a physical commodity, *e.g.,* electricity, coal, natural gas, and the like. Ownership of a stock can be transferred coast to coast with a click of a button, but electricity must be delivered to the place it is to be used. Further, storage of electricity for future use, unlike other commodities such as gasoline, grain, coffee, *etc.* is not currently viable and thus electricity must be produced at the time it is used.

Each regional geographic market has a somewhat different set of demands driven by climate, weather, population, and industrial activity, among other factors. Each regional geographic market also has a somewhat different group of financial entity counterparties and non-financial entity counterparties available to meet these demands and thus able to enter into utility operations-related swaps needed for hedging price and supply risks. For example, a large merchant electric generation station in western Alabama might be available as a non-financial counterparty for a swap transaction to provide electricity to a specific site in Alabama. But that same entity would not necessarily be able to offer the electricity in Oregon, and so would not be able to help an Oregon-based utility hedge its risks. Further, owners of electrical generation facilities and distribution utilities, whether investor-owned utilities, cooperative utilities, merchant generation companies, or government-owned utilities, operate in their geographical proximity and as they balance their generation to meet changing demands on an hour-to-hour basis are the most likely trading counterparties in their regions. These regional market participants, unlike financial entities, have a vested interest in maintaining the reliability of the grid and ensuring that sufficient liquidity exists to manage their operations.

In Regional Transmission Organization (RTO) markets such as PJM and MISO, the market design is such that using financial swaps and futures contracts to manage risk is now the standard. This is because the RTO markets provide unlimited

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[6] By way of reference a single, 1 year 100 MW swap could have a roughly $25 million notional value. One-hundred MWs of power is enough to serve the average demand of approximately 75,000 residential customers.

physical liquidity in the day-ahead and real-time markets to ensure reliability of service, and thus converting a financial price hedge to a physically delivered product in real-time is, by design, the way these RTO markets function.

Because there are a limited number of counterparties for any particular operations-related swap sought by a utility, each financial or non-financial swap counterparty brings important market liquidity and diversity. The greater the number of counterparties, the greater the price competition. Conversely, reduced price competition necessarily increases prices.

OMU and the Special Entity Sub-Threshold

I would like to illustrate these points with examples from my utility's perspective.

OMU has been providing electric service to its community since 1900. OMU owns a coal-fired power plant and has surplus power that it sells into the wholesale market in order to offset transferring the fixed costs associated with such surplus capacity to its retail customers. OMU uses financial transactions in the forward market to lock in the best price for these sales, to reduce its market risk, to stabilize revenue, and, most importantly, to provide rate certainty to its customers/owners.

OMU's approach has been to enter into enabling agreements with the most active physical and financial traders with solid credit ratings in our region. Prior to the establishment of the special entity rule *de minimis* threshold, this short list of counterparties allowed OMU to accomplish the hedging necessary while spreading the credit risk among counterparties. Because OMU has been pragmatic in choosing its trading counterparties, limiting the population to those entities with superior credit ratings, the negotiated collateral agreements do not require OMU to post collateral unless it exceeds a specified credit limit.

However, since the CFTC's implementation of the special entity *de minimis* threshold, two of OMU's three largest counterparties, which are both utility-affiliated trading companies and not "swap dealers," are no longer willing to do business with OMU. They cite the compliance risk and lack of internal systems to keep track of special entity transactions and ensure that they do not exceed the threshold. This compliance risk is not due solely to their business with OMU, but also because they do business with multiple "special entities" across the country and in our region.

This means that swap dealers are the only entities willing to enter into swap transactions with OMU. Since OMU's ability to hedge via swaps bilaterally with physical generation owners in our region has been greatly diminished, OMU has seen the bid-ask spread from swap dealer counterparties widen.

Consequently, OMU has been forced to move most of its hedging transactions to the ICE trading platform, which offer futures contracts. This means that OMU can no longer take advantage of its negotiated collateral agreements, and instead must comply with initial and maintenance margin requirements to support its hedging activities. As a result, OMU's board of directors required OMU to establish reserves of $10 million to ensure that the utility can meet margin calls associated with its hedged positions. If this $10 million in incremental cash reserves were funded from our customers/owners, the result would be an approximate ten percent rate increase.

As noted above, there is a great deal of heterogeneity among APPA members, including in the use of hedging. Some make substantial use of hedging, and others do not. Likewise, of APPA members who do make use of hedging, a recent informal survey of members showed great diversity in terms of the volume of hedging and the extent to which members relied on non-financial entities. Also, smaller members who are unlikely to hedge may still be affected, if they buy power from larger members who do.

The CFTC has said that it retained the $25 million threshold in light of the special protections that the Dodd-Frank Act affords to special entities. However, the statute does not require—even mention—special protections for special entities in regard to the swap dealer definition. As noted above, the law imposes requirements on swap dealers and major swap participants advising or entering into swaps with special entities. Nowhere does the law mention deeming a participant to be a swap dealer solely based on its volume of swaps with government-owned entities.

Government-owned utilities understand the operations-related swap transactions they use to manage their commercial risks and do not need the special protections provided by the $25 million sub-threshold. In fact, and ironically, these "protections" are likely to limit the ability of these utilities to hedge operational and price risks rather than to protect these utilities and their customers from risk.

Government-Owned Utilities' Petition for Rulemaking

On July 12, 2012, APPA, the Large Public Power Council (LPPC), the American Public Gas Association (APGA), the Transmission Access Policy Study Group (TAPS), and the Bonneville Power Administration (BPA), filed with the CFTC a "Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)." The petition requests that the CFTC amend its swap-dealer rule to exclude utility special entities' utility operations-related swap transactions from counting towards the special-entity threshold. This amendment to the swap-dealer rule would allow a producer, utility company, or other non-financial entity to enter into energy swaps with government-owned utilities without danger of being required to register as a "swap dealer" solely because of its dealings with government-owned utilities.

Specifically, the petition asks for a narrow exclusion:

- A government-owned utility's swaps related to utility operations would not count towards the special entity *de minimis* threshold, but would count towards the total *de minimis* threshold.
- Utility operations-related swaps are those entered into to hedge commercial risks intrinsically related to the utility's electric or natural gas facilities or operations, or to the utility's supply of natural gas or electricity to other utility special entities, or to its public service obligations to deliver electric energy or natural gas service to utility customers. For example, these would include swap transactions related to the generation, production, purchase, sale, or transportation of electric energy or natural gas, or related to fuel supply of electric generating facilities.
- Utility operations-related swaps do not include interest rate swaps. Those swaps would remain subject to the $25 million special entity sub-threshold.

CFTC "No Action" Letter

CFTC released on October 12, 2012 a no-action letter relating to the $25 million special entity sub-threshold. The letter allows a counterparty to deal in up to $800 million in swaps with government-owned utilities without being required to register as a swap dealer. As the CFTC explained in that letter, the $800 million is derived from a comment letter endorsed by the NFP EEU group suggesting that the special entity sub-threshold be set at 1⁄10 that of the overall swap dealer threshold.

The no-action letter, however, also included a number of additional limitations on a counterparty wishing to take advantage of the relief provided by the letter. Specifically, under the terms of the CFTC's no-action letter, the $800 million threshold applies only:

- If the special entity that is a party to the swap is using the swap to hedge a "physical position;"
- If the counterparty is not a "financial entity" as defined in the Commodity Exchange Act;
- If the swap is related to an exempt commodity in which both parties transact as part of the "normal course of their physical energy businesses;" and
- If a counterparty wanting to take advantage of the relief provided by the no-action letter files with the CFTC a notice that it is making use of the relief and provides, by December 31 (and quarterly thereafter), a list of each utility special entity with which it has entered into swaps and the total gross notional value of those swaps.

Certain counterparties have expressed concerns over one or more of the conditions imposed in the no-action letter, but it could also be that counterparties, in general, are not willing to spend the time and money to create a separate compliance process and adjust their policies and procedures in order to facilitate transactions with the small segment of any particular regional market that utility special entities represent. This is especially likely now as counterparties are focused on implementing compliance programs dealing with the whole range of Dodd-Frank requirements. Finally, there is the overarching issue that the no-action letter, by definition, is temporary and can be revised or revoked without any of the steps of a formal rulemaking process.

Whatever the reason, the no-action letter has failed to provide non-financial counterparties with the assurances they need to enter into swap transactions with our members.

A November 19, 2012, letter to the CFTC explaining this outcome has failed to produce any further action from the CFTC, and some Commissioners have indicated that we should turn to Congress to achieve the remedy we are seeking.

The Public Power Risk Management Act

On March 11, 2013, the Public Power Risk Manage Act of 2013 (H.R. 1038) was introduced by Congressman Doug LaMalfa (R–CA), a Member of this Committee, with fellow Committee Members Jim Costa (D–CA), Jeff Denham (R–CA), and John

Garamendi (D–CA), along with House Financial Services Committee Member Blaine Luetkemeyer (R–MO)

The legislation largely mirrors the intent and effect of the NFP EEU petition to the CFTC, providing narrowly targeted relief for operations-related swaps for government-owned utilities.

Specifically, the legislation would provide that the CFTC, in making a determination to exempt a swap dealer under the *de minimis* exception, shall treat a utility operations-related swap with a utility special entity the same as a utility operations-related swaps with any entity that is not a special entity.

Under the current threshold/sub-threshold regulatory regime adopted by the CFTC, this would mean that utility operations-related swaps with a government-owned power or natural gas utility would not be counted in calculating whether swap dealing activity exceeded the $25 million special entity *de minimis* threshold, but would be counted in calculating whether swap dealing activity exceeded the $8 billion *de minimis* threshold.

The legislation carefully defines which entities would qualify as a "utility special entity." It also specifically defines the types of swaps that could and could not be considered a "utility operations-related swap." For example, the legislation specifically prohibits interest, credit, equity, and currency swaps from being considered as a utility operations-related swap. Likewise, except in relation to their use as a fuel, commodity swaps in metal, agricultural, crude oil, or gasoline would not qualify either.

Finally, the legislation also confirms that utility operations-related swaps are fully subject to swap reporting requirements.

When implemented, this legislation should provide the certainty to non-financial entities that they can enter into swap transactions with government-owned utilities without fear of being deemed a swap dealer. It truly levels the playing field. And, it does nothing to otherwise alter the CFTC's implementation of the Dodd-Frank Act.

We wish the legislation were not necessary, but given the realities we face and the ongoing damage being done under the current rules, we urgently request the Members of this Committee to support this narrow legislative fix.

Finally, because of our experience with the $25 million sub-threshold, we are intrigued by another bipartisan bill recently introduced in the House. The legislation, H.R. 1003, would require the CFTC to quantify the costs and benefits of future regulations and orders. Sadly, the legislation is prospective, but we believe that had such an analysis been made, it could have prevented the turmoil currently being caused by the $25 million special entity sub-threshold.

Conclusion

In conclusion, the protections the CFTC is trying to afford through the $25 million special entity sub-threshold are not needed for utility operations-related swaps entered into by government-owned utilities.

Government-owned utilities are well-versed in the markets in which they are hedging their risks and rely on these swaps solely to manage price and operational risks.

More importantly, the assumption that financial firms will be able to replace all the swaps offered currently by our non-financial swap partners reflects a dangerous misunderstanding of how electricity is delivered and an indifference to the price Wall Street will impose in the absence of adequate competition.

In sum, a failure to allow the narrow relief provided under the Public Power Risk Management Act will limit our members' ability to hedge against risks and lead to increased risk and costs to the ratepayers they serve.

Thank you again for this opportunity to testify, and I would be more than happy to answer any questions you might have.

The CHAIRMAN. Thank you, Mr. Naulty.

You may proceed when you are ready, Mr. Thompson.

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

Mr. THOMPSON. Thank you, Mr. Chairman. I am Larry Thompson, General Counsel of The Depository Trust and Clearing Corporation, DTCC, a participant-owned and governed cooperative that serves as a critical financial market utility for the U.S. and global financial markets. DTCC strongly supports H.R. 742, the Swap Data Repository Clearinghouse Indemnification Correction Act of 2013. I want to thank Congressman Crawford and Maloney for their leadership on this issue.

I would like to focus on three points today. First, I will briefly review DTCC's role in the swaps market, second, I will explain the indemnification provision in Dodd-Frank and the problems it poses for swap data sharing and systemic risk oversight, and third, I will discuss a legislative remedy to resolve this matter.

DTCC has a long history serving the over-the-counter swaps market and going back to 2005, we are the only party that has run a swap data repository. More recently we began operating a U.S. swap data repository called DDR, which is a swap data repository registered with the CFTC under Dodd-Frank. The DDR began accepting trade data from clients the first day that financial institutions began trade reporting under Dodd-Frank. On December 31 we were the first and only registered swap data repository to publish real-time price information. DDR is also the only registered swap data repository to offer repository and public reporting across all five asset classes.

Earlier this week, we also announced that DTCC's registration application to establish a Japanese OTC derivatives trade repository was approved. DDRJ is the first trade repository to be approved and established for the Japanese market. We also have a trade repository registered with the FSA in the UK called DDRL.

Turning to my second point today, the indemnification provision in Dodd-Frank requires a registered swap data repository as a condition of sharing information with a foreign regulator to first receive a written statement and agreement with that regulator will abide by certain confidentiality requirements and indemnify both the SDR and the regulator for any expenses arising from the litigation relating to the information provided. We believe those provisions are complicated and unworkable.

First, many foreign countries and their legal systems do not recognize the concept of indemnification. Even where they do, many foreign governments cannot or will not agree to indemnify foreign private third parties such as U.S.-registered SDR or a foreign government. In order to access the necessary information without indemnification each jurisdiction may have to establish a local trade repository. A proliferation of local trade repositories would undermine the ability of regulators to obtain timely, consolidated, and accurate view of the global marketplace. The implementation of this provision will also undo the existing data sharing system that was developed through the OTC Derivatives Regulators Forum or ODRF and a Committee on Payment and Settlement Systems of the International Organization of Securities Commissions known as CPSS IOSCO.

For nearly 3 years regulators globally have followed the ODRF guidelines to access the information they need for systemic risk oversight. It is the standard that DTCC uses to provide regulators around the world with access to global credit, default swap, and interest rate data stored in its voluntary trade repositories, and it has worked well to date.

Turning my third and final point, during the 112th Congress the SEC testified in support of a legislative solution and three of the five CFTC Commissioners publicly endorsed the need for legislation to clarify this provision of Dodd-Frank. Furthermore, a bipartisan coalition of more than 40 lawmakers in the House signed on as co-sponsors of legislation similar to H.R. 742. The Dodd-Frank Indemnification Requirement has not been copied by regulators overseas. In fact, the European Market Infrastructure Regulation known as EMIR, considered and rejected the indemnification requirement. Congress should enact H.R. 742 to quickly issue a regulatory comity with international counterparts. By passing this legislation to ensure that technical corrections to indemnification are addressed, Congress will help create the proper environment for the development of a global trade repository system to support systemic risk management and oversight.

Thank you, and I await your questions.

[The prepared statement of Mr. Thompson follows:]

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

Thank you for holding today's hearing to examine legislative improvements to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The Depository Trust & Clearing Corporation (DTCC) supports efforts to improve the effectiveness of this landmark legislation, particularly in areas related to regulators' ability to access and utilize a global data set for systemic risk oversight and mitigation purposes.

DTCC strongly supports the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013 (H.R. 742), a bipartisan proposal cosponsored by Congressman Bill Huizenga (R–MI), Congressman Rick Crawford (R–AR), Congressman Sean Patrick Maloney (D–NY), and Congresswoman Gwen Moore (D–WI). H.R. 742 will resolve issues surrounding Dodd-Frank's indemnification provisions and confidentiality requirements.

My testimony today explains the Dodd-Frank indemnification provision, how it will fragment swap data, and how fragmentation will hinder regulators' efforts to oversee a global market. I also provide information on how indemnification risks negating the existing global data sharing framework. Finally, I will address the Commodity Futures Trading Commission's (CFTC) interpretive guidance, what it may mean for U.S. regulators, and explain why legislation is needed in this instance.

I appreciate the opportunity to bring greater attention to the unintended consequences of these provisions and the need for a legislative solution. These concerns have been echoed by regulatory officials and policymakers globally, including by representatives of the European Parliament, European Commission and Council, by Asian governments and by both Republican and Democratic Members of the U.S. Congress.

The Dodd-Frank Confidentiality and Indemnification Provisions

Sections 728 and 763 of Dodd-Frank apply to swap data repositories (SDRs) registered with the CFTC and the Securities and Exchange Commission (SEC), respectively. Prior to sharing information with U.S. Prudential Regulators, the Financial Stability Oversight Council, the Department of Justice, foreign financial supervisors (including foreign futures authorities), foreign central banks, or foreign ministries, Dodd-Frank requires (i) registered SDRs to receive a written agreement from each entity stating that the entity shall abide by certain confidentiality requirements relating to the information on swap transactions that is provided and (ii) each entity must agree to indemnify the SDR and the CFTC or the SEC (as applicable) for any expenses arising from litigation relating to the information provided.

In practice, these provisions have proven to be unworkable.

As an initial matter, indemnification is a common law concept with its origin in tort law. Many countries and their legal systems do not recognize indemnification, and further, many foreign governments cannot or will not agree to indemnify foreign, private third parties (U.S. registered SDRs). Further, regulators have noted that they are already following policies and procedures to safeguard and share data based on both the OTC Derivatives Regulators' Forum (ODRF) and the International Organization of Securities Commissions' (IOSCO) Multi-Lateral Memorandum of Understanding.

Indemnification Requirement Will Fragment the Global Data Set and Impede Regulatory Oversight

The continued presence of the indemnification requirement is a significant barrier to the ability of regulators globally to effectively utilize the transparency offered by a trade repository registered in the U.S. Without a Dodd-Frank compliant indemnity agreement, U.S.-registered SDRs may be legally precluded from providing regulators market data on transactions that are subject to their jurisdiction. In order to access the swap transaction information necessary to regulate market participants in their jurisdiction, global supervisors will be forced to establish local repositories to avoid indemnification.

Foreign regulators have noted concerns with a scenario in which a foreign regulator has an interest in certain data in a U.S. SDR resulting from a jurisdictional nexus with respect to the currency or underlying reference entity, where neither party to the transaction falls under the foreign regulator's oversight authority. For example, a U.S. and a London-based bank may trade on an equity swap involving a Japanese underlying entity, and the trade is reported to a U.S. SDR. If the Japan Financial Services Agency has an interest in accessing such data, it does not appear to be able to do so absent a confidentiality and indemnity agreement.

The creation of multiple SDRs will, by definition, fragment the current consolidated information by geographic boundaries. While each jurisdiction would have an SDR for its local information, it would be far less efficient, more expensive, and prone to error when compared with the current global information sharing arrangement in place today.

Further, a proliferation of local trade repositories would undermine the ability of regulators to obtain a timely, consolidated, and accurate view of the global marketplace. If a regulator can only "see" data from the SDR in its jurisdiction, then that regulator cannot get a fully aggregated and netted position of the entire market as a whole. And if a regulator cannot see the whole market, then the regulator cannot see risk building up in the system or provide adequate market surveillance and oversight. In short, regulators will be blind to market conditions as a direct result of the indemnification provision. In the name of transparency, this provision creates opacity.

This could have a profound impact for U.S. regulators if other jurisdictions adopt a provision like Dodd-Frank's confidentiality and indemnification requirement. The imposition of the indemnification requirement on foreign governments increases the potential that foreign regimes will adopt reciprocal provisions. The CFTC, SEC, and others may find themselves precluded from accessing non-U.S. SDR data unless they agree to indemnify the non-U.S. private third party trade repository. The SEC noted in testimony before the House Financial Services Committee last year that the agency "would be legally unable to meet any such indemnification requirement and has argued vigorously against similar requirements in other contexts." [1] The CFTC would likely face a similar challenge.

Indemnification Requirement Threatens Existing Global Data Sharing Framework

The indemnification provision threatens to undo the existing data sharing system that was developed through the cooperative efforts of more than 50 regulators worldwide under the auspices of the ODRF and the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS–IOSCO).

For nearly 3 years, regulators globally have followed the ODRF guidelines to access the information they need for systemic risk oversight. It is the standard that DTCC uses to provide regulators around the world with access to global credit default swap (CDS) and interest rates data stored in its trade repositories. For example, under ODRF guidelines, regulators must maintain the confidentiality of information they obtain from DTCC's trade repositories and must affirm that information obtained is of material interest to their oversight.

The Dodd-Frank indemnification requirement has not been copied by Asian and European regulators. In fact, the European Market Infrastructure Regulation

[1] *H.R. ____, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2012: Hearing Before the H. Comm. on Fin. Servs.,* 112th Cong. (2012) (statement by Ethiopis Tafara, Director, Office of International Affairs, SEC), available at *http://financialservices.house.gov/uploadedfiles/hhrg-112-ba-wstate-etafara-20120321.pdf.*

(EMIR) considered and rejected an indemnification requirement. Congress should enact H.R. 742 quickly to bring American law in line with the rest of the world.

Limitations of the Commodity Futures Trading Commission Interpretive Statement

In May 2012, the CFTC issued an *Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of the Commodity Exchange Act* (Interpretive Statement). DTCC appreciates the Commission's serious effort to address these problems in the context of its rulemaking authority. However, due to the limitations inherent in a regulatory modification to a statutory problem, and in light of discussions with regulators globally, the language of the statute ultimately requires a "legislative fix" to clarify the scope and applicability of Dodd-Frank's confidentiality and indemnification provisions. Many regulators globally have expressed to DTCC the belief that a legislative resolution is needed to address the issues presented by this provision. Congress should act to bring certainty and clarity to global swaps markets.

While the Interpretative Statement provides clarification with respect to how the Commission proposes to construe the application of Dodd-Frank, it does not provide complete resolution to the concerns expressed by foreign regulatory authorities relating to regulator access. Even with adoption of the Interpretative Statement, which DTCC supports as a necessary first step, the indemnification provisions may still cause limited data sharing across jurisdictions.

The Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013

The *Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013* would make U.S. law consistent with existing international standards by removing the indemnification provisions from sections 728 and 763 of Dodd-Frank. DTCC strongly supports this legislation, which we believe represents the only viable solution to the unintended consequences of indemnification.

H.R. 742 is necessary because the statutory language in Dodd-Frank leaves little room for regulators to act without U.S. Congressional intervention. This point was reinforced in the CFTC/SEC January 2012 *Joint Report on International Swap Regulation,* which noted that the Commissions "are working to develop solutions that provide access to foreign regulators in a manner consistent with the DFA and to ensure access to foreign-based information." [2] It indicates legislation is needed, saying that "Congress may determine that a legislative amendment to the indemnification provision is appropriate." [3]

H.R. 742 would send a clear message to the international community that the United States is strongly committed to global data sharing and determined to avoid fragmenting the current global data set for over-the-counter (OTC) derivatives. By amending and passing this legislation to ensure that technical corrections to indemnification are addressed, Congress will help create the proper environment for the development of a global trade repository system to support systemic risk management and oversight.

Bipartisan and Regulatory Support for the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013

The SEC supports removing the indemnification provision from the DFA. During a hearing of the House Financial Services Capital Markets Subcommittee last year, the Commission testified that the "indemnification requirement interferes with access to essential information, including information about the cross-border OTC derivatives markets. In removing the indemnification requirement, Congress would assist the SEC, as well as other U.S. regulators, in securing the access it needs to data held in global trade repositories. Removing the indemnification requirement would address a significant issue of contention with our foreign counterparts, while leaving intact confidentiality protections for the information provided." [4]

CFTC Commissioners Scott O'Malia, Bart Chilton, and Jill Sommers have publicly stated their support for a legislative solution to address the unintended consequences of the provision.[5] Recently, during a Senate Committee on Agriculture,

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[2] CFTC and SEC, *Joint Report on International Swap Regulation* (Jan. 31, 2012), at 103, available at *http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/dfstudy_isr_013112.pdf.*

[3] *Id.*

[4] H.R. ____, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2012: Hearing Before the H. Comm. on Fin. Servs., 112th Cong. (2012), *supra* note 1.

[5] *See* Commissioner Jill Sommers and Commissioner Scott O'Malia, Dissenting Statement, Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of Section

Nutrition, and Forestry hearing, CFTC Chairman Gary Gensler identified the indemnification issue as one that Congress may address.[6]

There is bicameral, bipartisan support to resolve the consequences of indemnification. In the last Congress, H.R. 4235 secured 41 cosponsors and was the only DFA corrections bill to garner bipartisan, bicameral support. While the legislation passed the House Financial Services Committee, it was ultimately taken off the House Agriculture Committee hearing calendar.

In addition, several other Members of Congress have publicly declared their support for a technical correction to the provision. Senator Agriculture Committee Chairwoman Debbie Stabenow (D–MI) and former Ranking Member Pat Roberts (R–KS), and former House Appropriations Agriculture Subcommittee Congressman Jack Kingston (R–GA) and Ranking Member Sam Farr (D–CA), authored separate letters to their counterparts in the European Parliament expressing interest in working together on a solution to this issue.[7]

DTCC Has Experience Operating Global Trade Repositories

DTCC provides critical infrastructure to serve all participants in the financial industry, including investors, commercial end-users, broker-dealers, banks, insurance carriers, and mutual funds. We operate as a cooperative that is owned collectively by its users and governed by a diverse Board of Directors.

DTCC has extensive experience operating as a trade repository and meeting transparency needs.

We provide trade repository services in the U.S., the UK, Japan, Singapore and The Netherlands and have established a global trio of fully replicated GTR data centers. To support Dodd-Frank requirements, the DTCC Data Repository (DDR) applied for and received provisional registration from the CFTC to operate a multi-asset-class SDR for OTC credit, equity, interest rate, foreign exchange (FX) and commodity derivatives in the U.S. DDR began accepting trade data from its clients on October 12, 2012—the first day that financial institutions began trade reporting under the DFA. Furthermore, on December 31, DDR was the first and only registered SDR to publish real-time price information. DTCC has been providing public aggregate information for the CDS market on a weekly basis, including both open positions and turnover data, since January 2009. This information is available, free of charge, on *www.dtcc.com.*

Last week, DTCC announced that registered swaps dealers are now submitting OTC derivatives trade information for all five major asset classes into the DDR. The DDR is the only repository to offer reporting across all asset classes, a major milestone in meeting regulatory calls for robust trade reporting and risk mitigation in the global OTC derivatives market. Currently, there are approximately three million new positions across asset classes for a total of nearly seven million positions registered in the DDR.

I am pleased to report that DTCC's application for registration to establish a Japanese OTC derivatives trade repository was recently approved by the Financial Services Agency of Japan (J–FSA). DTCC will begin operating this service ahead of the J–FSA's mandated April 1 deadline for market participants in Japan to begin reporting their OTC derivatives transactions. DTCC Data Repository (Japan) KK (DDRJ) is the first trade repository to be approved and established for the Japanese market. DDRJ will support trade reporting across four major OTC derivatives asset classes including credit, equities, interest rates, and FX.

In 2012, DTCC expanded the Global Trade Repository (GTR) in order to support mandatory regulatory reporting requirements for over-the-counter (OTC) derivatives. The GTR, which holds detailed data on OTC derivatives transactions globally, gives market participants and regulators an unprecedented degree of transparency into this $650 trillion market—an essential tool for managing systemic risk.

21(d) of the Commodity Exchange Act, available at *http://www.cftc.gov/PressRoom/SpeechesTestimony/sommers_omailadissentstatement; see also* Dodd-Frank Derivatives Reform: Challenges Facing U.S. and International Markets: Hearing Before the H. Comm. on Agric., 112th Cong. (2012) (Commissioner Bart Chilton expressing support for a legislative solution), transcript available at *http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/transcripts/112/112-35New.pdf.*

[6] *See* Oversight of the Commodity Futures Trading Commission: Hearing Before the S. Comm. on Agric., Nutrition, and Forestry, 113th Cong. (2011) (colloquy between Chairman Gensler and Senator Saxby Chambliss).

[7] *See* Letter from Representative Jack Kingston and Representative Sam Farr to Mr. Sharon Bowles, Mr. Jean-Paul Gauzes, Dr. Werner Langen, and Mr. Gabor Butor (May 18, 2011); *see also* Letter from Senator Debbie Stabenow and Senator Pat Roberts to Ms. Sharon Bowles and Dr. Werner Langen (June 2, 2011).

The GTR is now established as the industry's preferred provider for global OTC derivatives reporting. It holds data on more than 98% of credit default swaps, 70% of interest rate derivatives and 60% of equities derivatives traded globally—and it is expanding to include foreign exchange and commodities derivatives.

Thanks in large part to the financial industry's voluntary effort to report data to the GTR, the CDS market is the most transparent in the world as far as regulatory understanding of counterparty exposures. In fact, we believe the CDS market is even more transparent than the equity and bond markets.

The GTR's Regulators Portal, which provides detailed information on counterparty positions as well as notional and transaction-level data, is leveraged on a regular basis by more than 40 supervisors globally to help manage sovereign debt crises, corporate failures, credit downgrades and significant losses by financial institutions. The portal is the first global service of its kind in the financial marketplace to provide regulators with granular data on transactions that occur within their jurisdictions.

Although DTCC and the industry continue to work closely to meet regulatory reporting requirements, the obstacles presented by the DFA indemnification provisions and confidentiality requirements aren't going away. Ultimately, Congress must act to avoid further unintended consequences and to ensure market transparency and risk mitigation of global financial markets.

Thank you for your time and attention this morning. I am happy to answer any questions that you may have.

The CHAIRMAN. Thank you, Mr. Thompson.

Ms. Hollein, you may begin when you are ready.

STATEMENT OF MARIE N. HOLLEIN, C.T.P., PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL EXECUTIVES INTERNATIONAL AND FINANCIAL EXECUTIVES RESEARCH FOUNDATION, WASHINGTON, D.C.; ON BEHALF OF COALITION FOR DERIVATIVES END-USERS

Mr. HOLLEIN. Thank you. Chairman Lucas, Ranking Member Peterson, and Members of the Committee, I want to thank you for inviting me to testify today. I am the President and CEO of Financial Executives International, the professional association of 15,000 senior-level financial executives from over 8,000 companies across all industries.

For more than 30 years I worked in the treasury function of several major corporations, including Westinghouse, Citicorp, ABN AMRO, and led CPMG's treasury practice for non-financial institutions. Today I speak on behalf of FEI and the Coalition for Derivatives End-Users. The coalition includes more than 300 companies and trade associations representing thousands of end-users united in one respect. They use derivatives to manage risk, not create it.

Corporate treasurers utilize over-the-counter derivatives to hedge and mitigate business risks, not for speculative purposes, which is why these end-users should not be regulated in a way that imposes unnecessary costs or restrictions. Congress heard our concerns in several respects and provided for key exemptions in Dodd-Frank for end-users.

Unfortunately, over the 2½ years since Dodd-Frank was enacted, it appears that these end-user exceptions are not being upheld in the rulemaking process. This is especially evident in the proposed margin rule and in the lack of clarity around inter-affiliate swaps and the use of treasury hedging centers.

Despite these issues the compliance clock keeps ticking toward imminent deadlines. The coalition strongly supports two pieces of legislation that have been referred to your Committee; H.R. 634

and H.R. 677. We would like to thank the Committee and the full House for supporting similar bills last Congress.

Today I will focus my comments on the Inter-Affiliate Swap Clarification Act, H.R. 677, introduced by Congressmen Stivers, Fudge, Gibson, and Moore. This legislation would ensure that inter-affiliate derivative trades do not face the same demanding regulatory requirements as market-facing swaps. This bill also ensures that end-users are not penalized for using treasury hedging centers to manage their commercial risks.

There are two serious problems facing end-users that needs to be addressed. First, under CFTC's proposed rule financial end-users would have to clear internal trades between affiliates unless they post variation margin or met specific requirements for an exception. Financial end-users such as pension plans, captive finance affiliates, and mutual life insurance companies use derivatives exactly the same way that non-financial end-users do.

If these end-users have to post variation margin, there is little point to exempt international-affiliate trades from clearing requirements as the cost could be similar. And let's not forget the larger point. Internal end-user trades do not create systemic risk and hence, should not be regulated the same as those trades that do.

Second, roughly ¼ of end-users we surveyed execute swaps through an affiliate. Many companies find it more efficient to manage their risks centrally instead of having hundreds of affiliates making trades in an uncoordinated fashion. Using this type of hedging unit centralizes expertise, strengthens financial controls, increases transparency, and improves price. These advantages led me to centralize the treasury function at Westinghouse while I was there.

However, the Regulators' interpretation of the Dodd-Frank Act confronts non-financial end-users with a choice, either clear all of their trades or dismantle their treasury hedging centers and find a new way to manage risk. Stated differently, this problem threatens to deny the end-user clearing exception to those who have chosen to hedge their risk in an efficient, highly-effective, and risk-reducing way. It is difficult to believe that this is the result Congress hoped to achieve.

For these reasons we hope Congress will pass H.R. 677.

Thank you, Mr. Chairman, and I look forward to the questions.

[The prepared statement of Ms. Hollein follows:]

PREPARED STATEMENT OF MARIE N. HOLLEIN, C.T.P., PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL EXECUTIVES INTERNATIONAL AND FINANCIAL EXECUTIVES RESEARCH FOUNDATION, WASHINGTON, D.C.; ON BEHALF OF COALITION FOR DERIVATIVES END-USERS

Chairman Lucas, Ranking Member Peterson, and Members of the Committee, I want to thank you for inviting me to testify today on the topic of legislative improvements to Title VII of the Dodd-Frank Act.

I am the President and Chief Executive Officer of Financial Executives International, the professional association of choice for 15,000 senior-level financial executives, from over 8,000 public and privately-held companies, across all industries. For 30 years before coming to FEI, I worked in the treasury functions of several major corporations, including Westinghouse, Citicorp, ABN AMRO, and Ruesch International and worked in the Financial Risk Management Practice leading treasury for non-financial institutions for KPMG.

Today I speak both on behalf of FEI and as a representative of the Coalition for Derivatives End-Users. The Coalition includes more than 300 end-user companies and trade associations and, collectively, we represent thousands of end-users from across the economy. Our members are united in one respect; they use derivatives to manage risk, not create it.

FEI as an organization is dedicated to advancing ethical and responsible financial management. As such, a number of FEI members, namely corporate treasurers, utilize over-the-counter derivatives to hedge and mitigate business risk. During the debate leading up to the Dodd-Frank Act, FEI worked alongside the Coalition to educate lawmakers on how derivatives are an effective tool used by non-financial companies for risk-management purposes and not for speculation, which is why end-users should not be regulated in a way that imposes unwieldy costs or unnecessary burdens. Congress heard our concerns in several respects and provided for key exceptions for end-users from some of the most burdensome derivatives requirements, such as central clearing requirements.

Unfortunately, over 2½ years since the enactment of the Dodd-Frank Act, it appears that the intent of these end-user exceptions is not being upheld in the rule-making process, as evidenced by the proposed margin rule and in the lack of clarity regarding companies that employ inter-affiliate swaps or use a centralized treasury hedging center. Despite these outstanding issues, the compliance clock keeps ticking away and companies must be ready to meet key deadlines.

For these reasons, the Coalition strongly supports two pieces of legislation that have been referred to your Committee, H.R. 634 and H.R. 677. We would like to thank the Committee for reporting similar bills by voice vote last Congress. Both bills subsequently passed the House by significant bipartisan majorities.

Today, I will focus my comments on the Inter-Affiliate Swap Clarification Act, H.R. 677, introduced by Congressmen Stivers, Fudge, Gibson and Moore. This legislation would ensure that inter-affiliate derivatives trades, which take place between affiliated entities within a corporate group, do not face the same demanding regulatory requirements as market-facing swaps. The legislation would also ensure that end-users are not penalized for using central hedging centers to manage their commercial risk.

There are two serious problems facing end-users that need addressing. First, under the CFTC's proposed inter-affiliate swap rule, financial end-users would have to clear purely internal trades between affiliates unless they posted variation margin between the affiliates or met specific requirements for an exception. The Coalition is comprised of both financial and non-financial end-user members, and financial end-users, such as pension plans, captive finance affiliates, mutual life insurance companies, and commercial companies with non-captive finance arms, use derivatives the same way non-financial end-users do. If these end-users have to post variation margin, there is little point to exempting inter-affiliate trades from clearing requirements, as the costs could be similar. And let's not forget the larger point—internal end-user trades do not create systemic risk and, hence, should not be regulated the same as those trades that do.

Second, many end-users—approximately ¼ of those we surveyed—execute swaps through an affiliate. This of course makes sense, as many companies find it more efficient to manage their risk centrally, to have one affiliate trading in the open market, instead of dozens or hundreds of affiliates making trades in an uncoordinated fashion. Using this type of hedging unit centralizes expertise, allows companies to reduce the number of trades with the street and improves pricing. These advantages led me to centralize the treasury function at Westinghouse while I was there. However, the regulators' interpretation of the Dodd-Frank Act confronts non-financial end-users with a choice: either dismantle their central hedging centers and find a new way to manage risk, or clear all of their trades. Stated another way, this problem threatens to deny the end-user clearing exception to those end-users who have chosen to hedge their risk in an efficient, highly-effective and risk-reducing way. It is difficult to believe that this is the result Congress hoped to achieve.

The Coalition believes that regulation of inter-affiliate swaps should square with the economic reality that inter-affiliate swaps do not pose systemic risk. H.R. 677 would make sure that end-users will not be forced to clear swaps simply because they use inter-affiliate trades or a centralized hedging structure. Thank you Chairman Lucas, I will be happy to answer any questions Members of the Committee might have.

The CHAIRMAN. Thank you, and the chair now recognizes Mr. Turbeville whenever you are ready, sir.

STATEMENT OF WALLACE C. TURBEVILLE, SENIOR FELLOW, DEMOS, NEW YORK, NY; ON BEHALF OF AMERICANS FOR FINANCIAL REFORM

Mr. TURBEVILLE. Thank you, Chairman Lucas and Members of the Committee. Thanks for having me here.

My name is Wallace Turbeville. I am a Senior Fellow at Demos, which is a national public policy organization working to reduce political and economic inequality, advancing a vision of a country where we all have an equal say in our democracy, and have an equal chance in our economy. I am talking today on behalf of Americans for Financial Reform, which is a coalition of more than 250 organizations which have come together to advocate for the reform of the financial sector. I would like to thank Marcus Stanley, AFR's Policy Director, for assisting with the preparation of my testimony.

I come to this testimony with a strangely appropriate set of experiences. First of all, I was born near Owensboro, Kentucky, which is not exactly qualification, but I did practice law in municipal bonds and worked with many municipal utilities for many years and then went onto Goldman Sachs to work in its municipal bond department for many years. After being at Goldman Sachs in Europe and elsewhere, I moved onto an international infrastructure finance and ran a derivatives risk service company for 7 years as CEO. Then 2½ years ago I decided to devote myself 100 percent of my time to thinking and writing about the reform of the financial markets.

Today the Committee is considering seven pieces of legislation. Six of these would amend Title VII, and the cost-benefit analysis would amend another part of the Act. The Americans for Financial Reform oppose six of these legislative proposals. We do not oppose the matter that was discussed by the gentleman from DTCC.

In truth there is no urgency for technical amendments to Title VII at this time. This may seem surprising given the length of the scope of the legislation, but, in fact, what is happening is in large measure as Chairman Gensler pointed out, many of these issues are being dealt with on an ongoing basis.

Given the complexity of the swaps space and the approach of Dodd-Frank Act in relying on regulatory expertise to craft rules, Congress should think about whether it is premature to do some of these things. Specifically, there are several issues at play here. One is the business risk management section, H.R. 634. Now, the bill as has been talked about several times today, the whole issue of end-user margin is that the CFTC has not required end-users to post margin, but the risks that are associated with swaps that are margined are dead. Pure and simple. They are credit extensions. So the fact of the matter is that the Prudential Regulators have said it would be prudent for a bank who is doing a swap to set a threshold or a limit on how much debt they extend. To do otherwise would be to suggest that it would be prudent for banks to extend unlimited credit, which I think is hard to address.

There are a couple of other points I would like to make quickly before we just move on. One is associated with the whole notion of the push-out provision. As best I can tell the biggest concern about the push-out provision is that it might be more expensive to work through an affiliate by some of the banks.

As Chairman Gensler pointed out, many of the banks are working through affiliates in this area. I want to point out that the Federal Reserve tells us that JPMorgan has 3,391 affiliates in its organization, B of A, 2,091, Goldman Sachs, 3,115, Morgan Stanley, 2,884, and Lehman before it died had 2,800. So the banks can manage to work through affiliates. The primary cost associated with the push-out is a cost of capital. If you have to capitalize an affiliate as opposed to relying on the capital of an insured bank, the cost of capital may be higher.

But here is the point. That cost of capital may be higher. That might even cause some costs to be passed along to counterparties, but the alternative is to have the people of the United States grant a subsidy through their guarantees of these banks, and that is an inappropriate way to do things.

I am perfectly happy to talk about any and all of these other provisions, and I look forward to your questions. Thank you.

[The prepared statement of Mr. Turbeville follows:]

PREPARED STATEMENT OF WALLACE C. TURBEVILLE, SENIOR FELLOW, DEMOS, NEW YORK, NY; ON BEHALF OF AMERICANS FOR FINANCIAL REFORM

Chairman Lucas, Ranking Member Peterson and Members of the Committee, good morning and thank you for the opportunity to testify before the Committee today.

My name is Wallace Turbeville. I am a Senior Fellow at Demos, a national public policy organization working to reduce political and economic inequality, advancing a vision of a country where we all have an equal say in our democracy and an equal chance in our economy. I am testifying today on behalf of Americans for Financial Reform, a coalition of more than 250 organizations who have come together to advocate for the reform of the financial sector. I would also like to thank Marcus Stanley, AFR's Policy Director, for assistance in preparing this testimony.

I come to this testimony with extensive professional experience in both the derivatives markets and the commodity markets. For 7 years, I practiced law specializing in public and private securities offerings, primarily municipal bond offerings for states, local governments and governmental utilities. I was then an investment banker at Goldman Sachs in its Municipal Bond Department for more than twelve years, specializing in governmental utilities in the United States and in Europe. After leaving Goldman, I managed a small advisory firm specializing in infrastructure finance around the world. I also served as CEO of a firm providing counterparty credit management services in the derivatives markets. For the last 2 years, I have focused my efforts on financial system reforms, participating in dozens of formal comments and various roundtable discussions at the request of regulatory agencies, the vast majority of them related to Title VII of the Dodd-Frank Act. This experience has prepared me well to discuss the amendments of Title VII of the Dodd-Frank Act that are the subject of this hearing.

Today the Committee is considering seven pieces of legislation. Six of these would amend Title VII of the Dodd-Frank Act, and one would impose new requirements for cost-benefit analysis on the Commodity Futures Trading Commission (the "CFTC"). Americans for Financial Reform oppose six of these legislative proposals. The specific reasons for our opposition to each bill are outlined in detail in my written testimony and will also be outlined in opposition letters that we are submitting today or will be submitting in the future. A guiding principle for AFR is that the trillions of dollars in economic costs created by the 2008 financial crisis, as well as the numerous related problems revealed in Wall Street scandals, mean that we need increased oversight of our financial system and full implementation of the Dodd-Frank Act. This should not be a controversial position. Over 70 percent of the public supports tougher rules and enforcement for Wall Street, and similar proportions support the Dodd-Frank Act.[1] But the legislation offered here moves in the wrong

[1] Lake Research Partners, "Polling Memo: Two Year Anniversary Of The Wall Street Reform Law", July 18, 2012, available at *http://ourfinancialsecurity.org/blogs/wp-content/*

direction. Bills such as H.R. 992 would enable additional bailouts of Wall Street banks. Legislation such as H.R. 677 on inter-affiliate swaps or the discussion draft on extraterritorial derivatives regulation would effectively limit the ability of regulators to provide proper oversight of complex derivatives markets.

The title of this hearing suggests that the Committee is considering "improvements" of the derivatives provisions of the Dodd-Frank Act. Despite the fact that the great majority of the Dodd-Frank Act has not yet been implemented or tested in the market, it has been suggested that there is a need for "clarifications" and "technical amendments."

This has caused me to think carefully about the concepts of improvements, clarifications and technical amendments. Derivatives bristle with devilishly complex risks and valuation issues. Even a sophisticated bank might value the same derivative differently in separate organizational units of the bank.[2] It has been reported that the infamous "London Whale" episode involved the obscuring of massive risk positions at JP Morgan Chase, a firm that claims industry leadership in risk management, by alteration to the quantitative formulas measuring risk.[3] In this technical area, these concepts are likely to be viewed differently by those who evaluate the regulation of the derivatives markets differently.

In truth, there is no urgency for "technical amendments" to Title VII at this time. This may seem surprising given the length and scope of the legislation, but there are two good reasons that it is true. First, in almost every area Title VII grants regulators extensive discretion to tailor and fine tune the broad directives in the Dodd Frank Act, and to introduce exemptions if need be. Indeed, regulators have been generous in doing just that, perhaps to a fault. Second, almost none of the significant elements of Title VII have yet been fully implemented. Without implementation, claims about their supposed harms are unfounded—especially since the key elements of Title VII, such as clearing, exchange trading, and improved risk management, are hardly radical. They are based on tried and true solutions with which we have long experience in real markets.

Given the complexity of the swaps space, and the approach of the Dodd-Frank Act in relying on regulatory expertise to craft specific rules, Congress should not be advancing broad and sweeping statutory exemptions that overturn the judgment of expert regulators and effectively deregulate portions of the swaps market only a few years after the decision to regulate them for the first time. Given the delays in implementation of the Title VII provisions and the importance of gaining experience with how these provisions work once they are actually implemented, Congress should not be acting to delay their implementation even further. Yet several of the bills before you today do exactly that. For example, H.R. 677, the "Inter-affiliate Swap Clarification Act", would create an overbroad and sweeping exemption for all inter-affiliate swaps that completely ignores the nuanced and thoughtful work done by the CFTC in crafting its own rule proposal for inter-affiliate swaps. And H.R. 1003 would add burdensome additional cost-benefit analysis requirements to the Commodity Exchange Act, the effect of which would not be to improve the quality of rulemaking but instead to create indefinite additional delays in the implementation of financial reforms.

Instead, the Congressional emphasis now should be on supporting the drastically under-funded CFTC with adequate resources to complete Dodd-Frank rulemaking and to actually implement those rules through enforcement and market monitoring. Only then will Congress have the necessary information to examine how well these rules are actually working based on real data rather than the usual industry calls for deregulation and exemptions.

The proposed bill on extraterritorial jurisdiction creates a different kind of impediment for the CFTC. The derivatives markets are truly international with trading taking place in cyberspace. Events in other jurisdictions can easily spread to the U.S. through intricate interrelationships across markets. The nature of the regulations in other jurisdictions, as well as their timing and even existence, remains an unknown. The ideal approach to jurisdiction in these circumstances is for the law to provide broad jurisdiction to the CFTC and to enhance the prospect that the rules in other jurisdictions will be comparable to the U.S. approach. Broad jurisdiction

ourfinancialsecurity.org/uploads/2012/07/AFR-AARP-CRL-NCLR-Lake-Research-Dodd-Frank-Anniversary-Poll-MEMO-7-18-121.pdf.

[2] Arora, S., Barak, B., Brunnermeier, M., Ge, R., "Computational Complexity and Information Asymmetry in Financial Products," October 19, 2009, available at *http://scholar.princeton.edu/markus/publications/term/39*.

[3] Brinded, L., "JP Morgan's $2 Billion 'London Whale' Loss Challenges Industry's Risk Measures," *International Business Times,* June 13, 2012, available at *http://www.ibtimes.co.uk/articles/351700/20120613/jp-morgan-cio-bruno-iksil-london-whale.htm*.

means that there will be no gaps in terms of scope and timing. The exercise of jurisdiction can be managed through substituted compliance, if justified. Broad jurisdiction together with point-by-point examination of the rules of other jurisdictions will allow the CFTC to work with agencies of other jurisdictions to achieve regulatory harmony which reflects the U.S. approach to rules, an approach that will most certainly be the most prudent and efficient. Yet as I outline further in my testimony, the proposed bill on extraterritorial jurisdiction would interfere with this process and undermine the CFTC's ability to regulate swaps that directly affect the U.S. economy.

Americans for Financial Reform does not object to actual technical amendments, by which I mean amendments that make non-substantive and necessary changes to facilitate the achievement of the goals of the original statute. One of the bills before the Committee today, H.R. 742, the "Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013," fits this description well. AFR does not oppose it.

However, the other bills here are far from being "clarifications or technical amendments" and AFR does not see them as improvements. Instead, they significantly alter the Dodd-Frank Act in ways that effectively deregulate the financial sector and work against the goals of improving the safety, stability, fairness, and efficiency of our financial system.

I use the term "financial system" intentionally. Far too often, discourse on financial reform conflates the profitability of individual financial institutions with a safe, sound and efficient financial system. Financial institutions seek short term profits and massive earnings from derivatives, and all too often they are able to sustain the long term risks involved in this pursuit due to the public safety net that supports too-big-to-fail banks. Combined with the fact that executive pay is frequently determined by short-term profits, this means that short-term incentives dominate their behaviors, often at the expense of the public at large and the safety of the broader financial system. The Dodd-Frank Act puts sensible risk limits on activities in the derivatives markets. This is good for the financial system, even if it reduces the profitability potential of some financial institutions.

In thinking about the benefits of sensible limitations on derivatives activities, I would also like to add a personal note on one of the bills under consideration. H.R. 1038 purports to benefit public utilities by exempting them from some of the protections in Title VII of the Dodd Frank Act. This is a subject near and dear to my heart since I devoted most of my professional career to assistance of governmental enterprises in their capital-raising activities. In those years, I had the uncomfortable opportunity to witness sales calls by derivatives specialists on governmental utilities. I have seen the technique of fostering a sense of trust, encouraging an advisory relationship that can be exploited to sell an immensely profitable derivative when other alternatives could be better. As pointed out earlier, even the most sophisticated financial institutions struggle with evaluating the risks associated with derivatives. It is completely unreasonable to expect that governmental utilities will have the ability to measure the risks of derivative transactions. This is especially so given the massive incentives of swap dealers to ingratiate themselves as functional advisors and obfuscate their costs and risks. This means that swap dealers must be constrained in their dealings with governmental utilities. Their business conduct standards should be enhanced, not undercut. Public entities are at a major disadvantage in negotiating with swap dealers and the public's interest is in rectifying this imbalance, not facilitating it.

Below, I discuss the bills before you today in more detail. I would also refer you to the opposition letters that Americans for Financial Reform is submitting on most of these pieces of legislation.

Extraterritoriality

CFTC Chairman Gensler has correctly observed that a faulty extraterritoriality rule could blow a hole in the bottom of the ship of derivatives regulation. Modern markets are interrelated and trading occurs in cyberspace. The very concept of national jurisdictions is challenged by the modern financial system, especially in the area of derivatives.

American financial institutions operate derivatives businesses in many nations through branches and guaranteed affiliates. Moreover, foreign banks similarly maintain large derivatives businesses in the U.S. There is no assurance that financial regulations in those countries will regulate their activities using comparable standards, either in the form of written rules or in their application. Indeed, in some jurisdictions, there is no assurance when or even if rules will be finalized.

The discussion draft on extraterritoriality before the Committee today would greatly hamper the ability of the CFTC to effectively address the complex problem of extraterritoriality. It does this by undermining the jurisdiction granted to the agency in Section 722(d) of the Dodd-Frank Act and limiting the ability of the agency to work with foreign regulators to ensure the full comparability of U.S. and foreign derivatives rules. Given the centrality of proper cross-border regulation to effective oversight of the derivatives markets, as well as the potential exposure of the U.S. taxpayer and the U.S. financial system to failures in regulation abroad, it is of central importance to support the CFTC in implementing strong cross-border rules. Instead, this legislation would weaken it.

There is no doubt that the viability of the U.S. financial system is tied inextricably to international markets. In 2008, foreign banks needed access to U.S. dollars to avoid default on ongoing dollar denominated liabilities. They could not rely on borrowing dollars in the crippled U.S. commercial paper market. The only remaining source was the foreign exchange market in which dollars are swapped between U.S. and foreign banks as of a future date in exchange for other currencies, a $4 trillion ***per day*** market.[4] Banks in other countries came to doubt the reliability of U.S. banks—no one knew whether U.S. banks were solvent because they held huge quantities of toxic mortgage assets that could no longer be valued accurately. The market began to evaporate, as foreign banks feared that U.S. banks would not deliver the required currency on the appointed date. A worldwide collapse might ensue if the foreign banks defaulted for want of dollars. The Fed offered unlimited access to foreign central banks to swap dollars for foreign currency so that the central banks could in turn loan dollars to local banks, avoiding their default. Most accurately measured, the daily peak of Fed swaps exceeded $850 billion.

Under these circumstances, a prudent approach to extraterritoriality is essential. Jurisdiction and the exercise of jurisdiction are two different things. The best result is if the U.S. sets the standard for meaningful and prudent regulation and the foreign jurisdictions meet that standard. The best way to achieve that goal is to strive for broad jurisdiction for the CFTC. This likely means that jurisdictions will overlap. But that has several benefits. First, it will mean that there are no jurisdictional gaps that can be exploited. Second, it will mean that U.S. regulators will be in the best position to harmonize jurisdictional overlap under conditions in which the foreign rules are substantially comparable with U.S. rules. And for the period in which foreign rules are not in place, U.S. regulators can protect American taxpayers rather than allowing foreign activities to put the U.S. financial system at risk.

The language of Section 722(d) of the Dodd-Frank Act strikes this balance wisely. It gives the CFTC jurisdiction over any activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States." As stated above, the CFTC is not required to exercise this jurisdiction. It retains the option to tailor regulations to specific activities abroad. It is difficult to imagine any reason why the American public would not want to give our regulatory agencies jurisdiction over derivatives activities that have a "direct and significant connection" with the U.S. economy. If substituted compliance is appropriate, the CFTC can negotiate that out from a position of strength.

It is unwise to subject these kind of jurisdictional matters to the Administrative Procedures Act. The APA may be appropriate for the design of specific derivatives rules, but should not limit the proper application of these rules to all areas directly affecting the U.S. economy.

Further, the legislation would direct and limit the standard for comparability in a way that undercuts the discretion of the CFTC to work with foreign jurisdictions to achieve the standards that will protect the American public. The bill requires that, for G20 member nations, the agencies make overall comparability determinations based on the "broad comparability" of the entire regime in another country to the entire derivatives regime in this country. This eliminates the CFTC's ability to determine the comparability of other national regimes in specific areas and to permit substituted comparability for some requirements and not others. Given the scope of derivatives requirements this regulatory flexibility is valuable. Indeed, it is possible that the ability to approve on a point-by-point basis will allow regulatory agencies to be more permissive in some cases (by permitting substituted requirements for a few requirements when the overall regime is not comparable). If substituted compliance is implemented, the CFTC should be empowered and encouraged to vigorously work through the elements of regulatory regimes on an ongoing basis to make certain that the high standards required by Congress and the American people are upheld in every jurisdiction that could be the source of grave harm to the American economy.

[4] Bank for International Settlements, "Triennial Central Bank Survey, Report on Global Foreign Exchange Market Activity in 2010," December 2010, available at *http://www.bis.org/publ/rpfxf10t.pdf*.

Finally, SEC extraterritoriality jurisdiction has its origin in a regulatory mandate that is very different from the CFTC. The nature of the derivatives markets regulated by the CFTC demands the standards set forth in Section 722(d). If the two standards were to be reconciled, it only makes sense that the language of Section 722(d) would prevail. In a world in which a financial meltdown can easily and quickly be transmitted throughout the international system, it makes no sense to make fine distinctions about jurisdictions of organization or physical locations of offices when it comes to the derivatives markets.

Bank Derivatives Subsidiaries

Perhaps the most dramatic example before you today of legislation that undermines the goals of the Dodd-Frank Act is H.R. 992, the "Swaps Regulatory Improvement Act". This would amend Section 716 of the Dodd-Frank Act, a provision that bans public bailouts of a broad range of derivatives dealing activities. This ban would require Federally supported banks to transact their derivatives dealing business in separate corporations, not guaranteed by the banks. H.R. 992 weakens this section enormously by greatly increasing the types of swaps dealing activities that are exempted from the Section 716 ban on public bailouts of derivatives dealing. It would significantly expand the range of derivatives dealing that insured depository institutions, the banks most susceptible to public bailout, would be permitted to engage in and to fund. It is truly remarkable that only a few years after the bailout of AIG and the public support provided to derivatives dealing at numerous Wall Street banks, that we would see a proposal that allows additional public bailouts of Wall Street derivatives activities. Yet this is exactly what H.R. 992 would do.

Opposition to Section 716 is really an issue of cost. The Section 716 ban on public support would effectively require the affected institutions to separately capitalize subsidiaries to engage in derivatives dealing. We do not dispute that it would be cheaper for the banks to support this business using the cheap funding available through insured deposits. But that is because the public is forced to subsidize the cost of their capital because the failure of the banks would be potentially damaging to the public at large. The real question here is whether the public should subsidize these derivatives businesses. AFR and many others believe that the public should not. If these businesses cannot be done profitably without taxpayer subsidy, they should not be done.

It may be argued that the increased cost of capital will adversely affect pricing for derivatives market participants. This argument is superficial, especially in its implication that costs will increase on a dollar-for-dollar basis. However, to the extent the elimination of the subsidy increases cost, taxpayers generally will be benefited from the reduction of the subsidy. The Federal Government can always affect prices by granting taxpayer subsidies to any business. The use of subsidies in this area is a particularly dubious policy.

Any other result distorts the markets and constitutes a drag on the economy. The subsidized derivatives business has been immensely profitable for the banks. It has been estimated that devoting capital to support derivatives has been ten times more profitable than the use of that capital to support lending to American businesses and governments.[5] That figure is completely consistent with statements made to me by derivatives professionals. This is completely inconsistent with an efficient and transparent marketplace.

Margin Requirements

The stated purpose of H.R. 634, entitled the "Business Risk Mitigation and Price Stabilization Act," is "To provide end-user exemptions" from certain provisions of the Dodd-Frank Act. Those provisions deal with margining of swaps that are exempted from the clearing requirement. The collateralization of uncleared swaps is a vital area for the safety and soundness of both non-bank derivatives entities and for banks with extensive derivatives activities.

It is vital to understand that margin is collateral for real, not "technical" or imagined, extension of credit. If a swap moves out-of-the-money for a counterparty, the opposite counterparty is just as exposed to the credit of the out-of-the-money counterparty as if money had been loaned.[6] Variation margin collateralizes this credit exposure. But that is insufficient. The credit exposure is uncapped, so it can grow between the time variation margin was last posted and the time that a

[5] Corporation for Public Broadcasting, *Frontline,* "Money, Power and Wall Street," Episode 1, Remarks of Christopher Whalen, available at *http://video.pbs.org/video/2226666502*.

[6] Mello, A, and Parsons, J., "The Collateral Boogeyman—Packaging Credit Implicitly and Explicitly," October 2010, available at *http://bettingthebusiness.com/2010/10/*.

counterparty can react to the default of its opposite counterparty. Initial margin collateralizes that additional credit risk.

The bill would eliminate the authority of the CFTC and the SEC to require swap dealers and major swap participants who are not banks to include margining requirements for swaps affecting commercial end-users. This is unnecessary. The agencies have already elected not to require margin for uncleared swaps that originate from a non-financial end-user.[7] Not only is it unnecessary, it is potentially dangerous. Should the agencies discover in the future that unmargined swaps from commercial end-users create a risk to the safety and soundness of non-bank swap dealers, they may wish to reassess elements of their current rules. This statutory change prevents them from doing so.

But the bill goes further. It may affect the ability of Prudential Regulators from requiring that banks set a limit on the amount of credit extended to commercial end-user customers under derivatives before margin collateral is required. The Prudential Regulators have likewise not required margin of commercial end-users in most circumstances, but they have required a bank-set credit limit to the extent of unmargined derivatives.[8] While technically, there is no limit to the credit loss if prices run away from the bank before the derivative position can be covered, this would at least limit the likely amount of credit exposure. The Prudential Regulators do not impose a credit limit; they simply require the bank to set one as an exercise of basic prudence.

I would note that this bill does appear to be drafted fairly narrowly, striking only at Dodd-Frank authorities for margin requirements for non-financial end-users, and apparently not affecting authorities to require capital under Dodd-Frank or prudential authorities outside of Dodd-Frank. While we still believe the bill is at best unnecessary and at worst harmful, the narrow crafting of the bill is positive and must be preserved if this legislation is to move forward. It is critical that the exemption proposed in this bill does not affect the authority of Prudential Regulators to set reasonable credit limits in all cases, including the derivatives markets, and also that it does not affect the ability to require appropriate capital. That authority is critical to bank regulation. It also benefits end-user customers, who for their own safety should not incur excessive levels of concealed debt through derivatives exposures.

Cost-Benefit Analysis

The stated purpose of H.R. 1003 is "To improve consideration by the Commodity Futures Trading Commission of the costs and benefits of its regulations and orders." This proposed legislation would unnecessarily add numerous additional requirements to the already existing statutory cost-benefit requirements for the CFTC. These requirements could effectively paralyze the CFTC's ability to implement laws passed by Congress to safeguard our financial system. The rules affected would range from those designed to prevent excessive speculation that drives up prices for gas and other commodities to derivatives oversight necessary to prevent the repeat of a crisis like that of 2008.

The requirement for consideration of costs and benefits should not create an opportunity to reconsider the decisions made by Congress. Congress enacted a comprehensive regulatory regime that is intended to serve the interests of the public by making the derivatives markets more transparent, fairer and safer. The CFTC has finalized 40 rules implementing Dodd-Frank and 20 more remain to be finalized. Each has its own benefits and each is beneficial as part of a mosaic of financial reform. The steps that are required in the bill for each element of each rule envision a reconsideration of those decisions, first by the agency an then by the Courts on review. This is an inappropriate balancing of the branches of government and does not serve the public's interests.

Existing law (Section 15(a) of the Commodity Exchange Act) already requires the CFTC to consider the costs and benefits of regulatory action before issuing a new regulation. Existing law also requires the agency to consider the effects of any new regulation on the efficiency and competitiveness of the markets it supervises. In addition to such consideration, prior to any rulemaking the CFTC must consult extensively with industry and other interested parties who submit comments to the agency. Over the last 2 years the CFTC has collected and reviewed thousands of public comments and held numerous public round tables on Dodd-Frank rules.

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[7] CFTC Proposed Rule, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 *FR* 23732, available at *http://cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_5_CapMargin/index.htm;* SEC Proposed Rule, Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 78 *FR* 4365 available at *http://www.sec.gov/rules/proposed.shtml*.

[8] 76 *FR* 2764, Proposed Rule, Margin and Capital Requirements for Covered Swap Entities.

H.R. 1003 would add numerous additional requirements to these already extensive procedures. It would also force the agency to measure costs and benefits of a new rule before that rule was even implemented or market data resulting from the rule was available. The new requirements imposed by this bill also include enormously broad and vague mandates such as determining whether a regulation imposes the 'least burden possible' among all possible regulatory options. A court could overturn the CFTC's decision in any case where it found any one of the numerous analyses required here to be inadequate. The vagueness of mandates like the 'least burden possible' means that court challenges or court decisions could rest on claims that are essentially speculative and theoretical. These new mandates would not increase the quality of the regulatory process, they would stop it in its tracks,

These extensive new procedural requirements are being proposed even as the CFTC is being starved of the resources it needs to do its job. The massive new requirements added by H.R. 1840 would make the problem much worse. Any attempt to improve the analytic capacities of the CFTC and its capacities to assess the effectiveness of its rules must start with additional funding, not with piling on unnecessary additional mandates and requirements that will trigger additional litigation.

Swap Dealer Business Conduct Standards and Dealer Registration Rules Applicable to Governmental Entities

The stated purpose of H.R. 1038 is "To provide equal treatment for utility special entities using utility operations-related swaps, and for other purposes." This is a subject near and dear to my heart since I devoted most of my professional career to assistance of governmental enterprises in their capital-raising activities. Section 731 of the Dodd-Frank Act imposes enhanced business conduct standards on swap dealers transacting with "special entities," a term that includes state and local government agencies and Federal agencies. H.R. 1038 would carve out governmental electricity and gas utilities and Federal power marketing agencies. I suppose the "equal treatment" that is called for by the bill means equal treatment with far more sophisticated corporations rather than equal treatment with other governments and their agencies and instrumentalities.

In my career, I have had the uncomfortable opportunity to witness sales calls by derivatives specialists on governmental utilities. I have seen the technique of fostering a sense of trust, encouraging an advisory relationship that can be exploited to sell an immensely profitable derivative when other alternatives could be better. I have also seen the influence that can be brought to bear through politicians who have appointment power with regard to these utilities. Too often, derivatives can be structured to disguise debt from the public, a tempting alternative for officials who are concerned with public opinion.

As pointed out earlier, even the most sophisticated financial institutions struggle with evaluating the risks associated with derivatives. It is completely unreasonable to expect that governmental utilities will have the ability to measure the risks of derivative transactions. This is especially so given the massive incentives of swap dealers to ingratiate themselves as functional advisors and obfuscate the costs and risks and the complex influences on public servants. This means that registered swap dealers must be constrained in their dealings with governmental utilities. Their business conduct standards should be enhanced, not undercut. They are at a major disadvantage in negotiating with swap dealers and the public's interest is in rectifying this imbalance, not facilitating it.

It also means that firms that specialize in work with special entities, including governmental utilities, should register as swap dealers even though their business volumes are lower than the general registration thresholds. Special entities need the protection of swap dealer registration more than the typical market participants.

Interaffiliate Rules

H.R. 677, "The Inter-affiliate Swaps Clarification Act" would create a broad and sweeping exemption to Title VII margin, capital, clearing, and execution requirements between affiliated entities, so long as neither entity is an insured depository bank. "Affiliated" is defined broadly, as any two entities that do financial reporting on a consolidated basis.

This bill is ignores the careful work performed by regulators in making expert judgments concerning the implementation Act. The supporting materials for this bill claim that inter-affiliate swaps do not create systemic risk, and also that the Dodd-Frank Act should exempt them but does not. Yet the CFTC, in a lengthy and carefully reasoned proposal on the regulation of inter-affiliate swaps, outlined numerous ways in which inter-affiliate swaps can in fact create systemic risk. In addition, the CFTC proposal creates a balanced approach which partially exempts inter-affiliate swaps from some Title VII requirements while still retaining basic requirements for risk management, a limited use of margin to back swaps trades, and clearing in appropriate cases. Indeed, Americans for Financial Reform criticized the CFTC proposal for relaxing Title VII requirements excessively.

H.R. 667 would replace this framework with a sweeping and excessively broad exemption that would effectively leave inter-affiliate swaps completely unregulated under Title VII, with the exception of some reporting requirements.

The bill includes a number of limiting clauses restricting the effect of these exemptions on prudential regulation and insurance regulation. Last year Prudential Regulators insisted that these clauses be added to the prior version. This is because the control and regulation of inter-affiliate transfers of risk has been at the center of both banking and insurance regulation for over 50 years, since the passage of New Deal financial regulations and the passage of the Bank Holding Company Act. Of course, swaps are one of the most direct and effective ways to transfer risk. The centrality of the regulation of inter-affiliate risk transfers to oversight of large financial institutions should tell us that it is deeply misguided to completely exempt inter-affiliate transfers from the Title VII framework. Maintaining some of the basic requirements of Title VII for inter-affiliate swaps while granting exemptions only in the areas where it is appropriate, as the CFTC has recommended, is the correct approach.

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Thank you for the opportunity to provide the foregoing testimony. I hope that it is useful for your deliberations.

The CHAIRMAN. Thank you, sir.

I now recognize myself for 5 minutes, and I direct my first question I guess to Mr. Bentsen and Mr. Naulty. The derivative markets touch virtually every aspect of the economy, the food we eat, the price at the pump, our mortgages, credit cards, our retirement savings. With this in mind, do you think the CFTC rulemaking marathon since Dodd-Frank became law, are inherently flawed due to the lack of sufficient cost-benefit analysis?

Mr. BENTSEN. Thank you, Mr. Chairman, for the question. I don't know that I would go as far as to say they are all inherently flawed, but I think they are missing a key component in how you craft the rule as other departments and agencies either under statute or in adherence to the President's Executive Order look at how that rule is going to be crafted, what the cost, what the benefits are. And our view is that we don't really have an understanding as to what that is with respect to the CFTC rule proposals.

And so the whole idea behind cost-benefit analysis is to really help guide the agency in that rulemaking and to come out with what works best in trying to achieve that balance. So that has not been the case with the CFTC.

The CHAIRMAN. Mr. Naulty, would you like to add anything to that?

Mr. NAULTY. I share my colleague's concerns as it relates to the public power entities. The benefits are dubious, if any, for the treatment that we are receiving to classify us as a special entity solely because of the fact that we are a public entity doesn't recognize the fact that we manage the same risks in the same markets as our colleagues in the investor-owned utility space. We are very capable of managing and understand those risks, and although we have worked with the CFTC to make them aware of these concerns, we have not seen, and they have taken some action, we have not seen the end benefit that we need, which is this exemption that we are asking for.

The CHAIRMAN. Speaking of that, Mr. Naulty, in your testimony you stated CFTC's no-action letter in response to your industry's petition to eliminate the special entities threshold has not given your would-be counterparties enough confidence to resume doing business with public power utilities.

Do you think our bureaucrats having essentially eliminated an avenue for which you have to manage your risks, do you think your regulators up here really know how better to run your business in Owensboro than you do?

Mr. NAULTY. Well, I think that is a risk, Congressman, Chairman, that you get when you use a broader brush to paint over an issue like this, and we certainly understand how to run our business. You know, we are watching out for our ratepayers and to take away this avenue that we have used traditionally, and by the way, the way the market is designed, it was designed to allow and promoted the use of swaps in order to provide price certainty both for buyers and sellers in these RTO markets.

I think we do understand our business, and we can manage our own risks on an even playing field with investor-owned utilities.

The CHAIRMAN. Mr. Bentsen, one last question. I understand there is what might be described as a brewing disconnect between the U.S. and the EU on the Basel III derivatives rules. Could you expand on this developing issue and the potential impact on U.S. financial institutions?

Mr. BENTSEN. Yes.

The CHAIRMAN. And users for that matter.

Mr. BENTSEN. Yes, Mr. Chairman. This is—and I mentioned in my oral testimony, the European Union is in the process of finalizing the adoption of their implementation of Basel III, which is the international capital accords that the U.S., all of the G20 countries have agreed to implement. The U.S. is going through its own rulemaking, principally through the Federal Reserve to implement Basel III capital standards.

The European Union's proposal, which is called CRD–4, Capital Regulation Directive 4, would exempt swaps between EU-supervised banks or dealers who are otherwise subject to the Basel III requirements under the EU supervision, with swaps that they engage in with EU non-financial end-users as it relates to something called the credit evaluation adjustment. So it is an advanced methodology for establishing a capital requirement against that swap.

What that means is that for swaps, if this goes to fruition, which it appears that it will, what that means is that the capital charge that EU-supervised banks would have to take to engage in a swap with an EU non-financial end-user would be different and less than a non-EU bank, that could be a U.S. bank, an Asian bank, a Canadian bank, and engaging with those EU end-users, and frankly would be a disadvantage presumably to non-EU end-users as well in terms of a competitive disadvantage.

I think the other, and let me say, there is a problem with the CVA calculation, the calibration. No question about that, and I think that is why this happened, but importantly this results in a further fragmentation of trying to have a uniform standard set across the G20 countries, and in this case in the Basel Rule. So this is a real problem that we believe U.S. regulators and global regulators to the Basel Committee at the National Stability Board and others need to engage on.

The CHAIRMAN. Thank you. My times has expired.

The chair now recognizes the gentleman from Georgia for 5 minutes. Mr. Scott.

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

Mr. Bentsen, let me start with you. Concerning extra-territorial application of the Dodd-Frank rules, I gathered in your testimony that you have concerns with that, and I would like for you to tell us the most negative consequences that you see for the marketplace if Congress doesn't address this.

Mr. BENTSEN. Well, I think there are multiple negative consequences, Mr. Scott. Number one is you have in this interim period where the CFTC came out with its guidance and really in our views go ahead of the curve not waiting to do this with the SEC, which is still in a rulemaking process. Remember, this is something where this pivots off of the definition of what is a swap, what is a swap dealer, which was a joint rulemaking as prescribed by Congress under the Act and yet the CFTC went on its own to do this without doing it in a joint rulemaking with the SEC.

But also it got out in front and we believe in lack of coordination with our other regulators around the globe as was talked about with Chairman Gensler earlier today, and that has created conflict not just with those regulators, but it has created conflict in the marketplace, and I think you referenced this in your comments, Mr. Scott. I was actually in Tokyo on October 12 when the first instance of swap requirements were going to take effect at the World Bank and IMF meetings with a program with the Japanese Security Dealers Association. And at that time I was hearing from both U.S. and non-U.S. firms that they were getting pushback from non-U.S. swap dealer counterparties who hadn't, that they weren't clear whether they would deal with someone who is registered as a swap dealer.

So it created a market fluctuation that didn't need to exist, and that continues to happen.

The second thing I would say is you have a potential for redundancy and conflict between U.S. and non-U.S. rules where it is not clear who will be required, who will be subject to those rules and whether or not some dealers will be subject to duplicative or redundant rules which has no question will have a price in competitive impact.

So I think there are a number of things that come out of it. One is market fluctuation. The other is complexity and redundancy and conflict.

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

Mr. Thompson, let me ask you, you talked about the indemnification not being a legal concept as respected by foreign jurisdictions, and could you share with us why in H.R. 742 we need to make this change, and if we don't, what those consequences would be? How does that indemnification not being accepted by foreign jurisdictions have a negative impact?

Mr. THOMPSON. Thank you, Congressman Scott. First, indemnification basically comes out of U.S. common law tort law, and a lot of foreign jurisdictions follow civil law, especially in Europe so that is a concept that they simply don't have. But just here in the U.S. a lot of foreign governments just like we do not allow our governmental authorities to actually indemnify each other. The SEC, when they testified on this issue, actually said that if they had to indemnify a foreign regulator, they couldn't because U.S. law would not allow them to do it. So if they had to indemnify the CFTC in order to get information, they couldn't do it, which is one of the reasons that they came out in favor of a legislative solution here.

We think, as I have said and testified before, that the best way to assure that these global markets continue to stay global and you don't have local solutions to deal with this issue, is to do away with any impediments or fragmentation, and we see indemnification as an impediment to the globalization of the market.

Mr. DAVID SCOTT of Georgia. I just have to get one more little question in. There have been scores of economists that argue that excessive speculation in commodities derivatives has been a driving factor in recent radical price swings and market uncertainty, and I am hearing a lot of this from our main street businesses.

Do you all believe that excessive speculation is a factor behind the kinds of price swings that we have seen over the last 5 years?

Start with you, Mr. Bentsen. Do you believe that?

Mr. BENTSEN. Yes. There has been a lot of academic research in this area, Congressman, over whether or not, to what effect does market speculation impact price, and this goes to the whole question of position limits, and Chairman Gensler talked about that before.

And we can talk about the rule itself and why we had problems with it, and that gets really more to cost-benefit, but I think what is important is the academic research is quite frankly inconclusive as to the material impact of speculation on actual price. I think that is something that regulators, not just in the U.S. but globally, because the other thing we have to remember is commodity markets you all know better than we, commodity markets are global markets, and they are impacted by various global factors, and that is another thing that has to be taken into consideration.

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

The CHAIRMAN. The gentleman's time has expired.

The chair recognizes himself for a motion.

Without objection I would like to submit the following letters for the record, the first from the U.S. Chamber of Commerce supporting H.R. 992, a second from the Illinois Chamber of Commerce supporting H.R. 992, third, a February, 2013, letter from the Japanese Financial Services Agency to the CFTC expressing their concerns about cross-border rules.

Seeing no objection, so ordered.

[The information referred to is located on p. 115.]

The CHAIRMAN. With that I now recognize the gentleman from California, Mr. LaMalfa, for 5 minutes.

Mr. LAMALFA. Thanks, Mr. Chairman.

One question for Mr. Naulty there. First, Owensboro, isn't that the home of the Waltrip family there?

There is a second question but——

Mr. NAULTY. Congressman, I am not a NASCAR fan, so I don't know the answer to that question unfortunately.

Mr. LAMALFA. Well, okay.

Mr. NAULTY. But I do thank you for your leadership and your sponsorship of our legislation.

Mr. LAMALFA. The Waltrips would probably like me to sponsor them somehow, but, anyway, I just wanted to drill down a little more on that no-action letter that you mentioned in your comments there, which as you mentioned added additional requirements. Does that letter really inspire the confidence that you need to go forward or that your counterparties would as well, which we are gathering it doesn't.

Mr. NAULTY. Well, I think the answer to your question, Congressman, is that the proof is in the pudding, and while the no-action letter has been in place for quite some time, we have not seen any counterparties come back, and part of the reason is because of the uncertainty around some of the additional requirements and what the CFTC decided, tried to clarify in that letter but mostly because of the compliance risk that those counterparties perceive they would be burdened with. The compliance risk is that if they continue to do business with special entities and somehow trip over the threshold level, they would be pulled in as a swap dealer, and rather than putting in the systems and risk controls within their organizations, many of which are not large swap dealers, we are talking utility-affiliated trading companies, that cost-benefit just doesn't work for them. And so the easiest thing for them to do is to just not trade with special entities.

Mr. LAMALFA. Limiting options. Yes. Maybe we could follow up later and talk about some of those specifics, those requirements, but additionally, I would like to find out the largest municipal utility in my district has a little under 45,000 customers, and we have been talking, and they are expecting that the reporting requirements under Dodd-Frank are going to require additional staff and costs that, again, a fairly small utility like the one where I am from can't really bear.

I wondered what you might be able to share with us on the effects with Owensboro there.

Mr. NAULTY. Well, the reporting requirements are actually the requirements that would be imposed on the swap dealer, and while there are additional reporting requirements for us as municipal utilities, due to the fact that we do transactions that involve swaps, they are not nearly as onerous as those that would be imposed on entities that are trying to avoid being swap dealers.

There is a compliance burden. Make no doubt about it for us and for all APPA members that use these derivative markets. We have not quantified exactly how many headcount we are going to have to add, but clearly there is an additional compliance burden for us.

Mr. LAMALFA. But an even bigger deterrent for your counterparties there that in a spectrum of things that are going to drive their costs and probably not——

Mr. NAULTY. Yes.

Mr. LAMALFA.—as likely to do business with you then.

Mr. NAULTY. Correct, and as it drives their costs, then they become less competitive as a supplier or a buyer of our products. You know, the real issue for us is that these are costs that are being imposed on our business. The inability to access the markets in an equal way as our investor-owned utility counterparties and those costs, we have no other choice but to pass those through to ratepayers, and there is really no systemic risk and no benefit to the ratepayer for this penalty.

Mr. LAMALFA. Now, we haven't seen where the risk has been a problem for utilities in this process here, so, well, maybe just make it up in volume.

Thank you. I yield back my time.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman. Ma'am, Gentlemen, thank you for being here today, and Mr. Colby and Ms. Hollein, I, along with many of my colleagues, both Democrats and Republicans, have cosponsored H.R. 634, very similar to the bill that passed the House of Representatives last year, 370 to 24, that allowed end-users who qualified for the clearing exemption to also qualify for the margin exemption, basically making sure that the cost of the margin exemption is only used where a systemic risk to the financial markets is.

Secretary Gensler gave an indication earlier today that he was supportive of that and that he thought that a rule would be coming forward that would be very similar to that.

My question for you is have you heard any timeline on that particular rule, and could you just explain briefly why it is so important to allow end-users to be exempt from the cost of the margin requirements?

Mr. COLBY. Do you want me to start?

Mr. AUSTIN SCOTT of Georgia. Yes, sir. That is fine.

Mr. COLBY. Sorry. We haven't heard of a very specific timeline being provided. Although the CFTC has indicated in their preliminary ruling that they are supportive of commercial end-users not being required to post margin, the proposed rules by the Prudential Regulators is very troublesome, and even if the final rules don't require end-users to post initial margin and if they are high thresholds for variation margins, there are not assurances that in the future those rules might not change and be imposed upon us.

The bill does provide such certainty, and it should be noted that Chairman Bernanke has on the record in front of the Senate Banking Committee indicated that he would be supportive of such an explicit exemption for end-users.

Ms. HOLLEIN. Congressman, I agree with Mr. Colby as far as the margin requirements. The issue is most non-end-users really hedge for the sake of mitigating their risk, especially on the inter-affiliate agreements. It is just centralizing and more treasuries have moved towards the centralization process. It is the best practice to just be more efficient. It does not cause systemic risk or counterparty risk. If you think about it, the end-users only make up as Chairman Gensler mentioned, nine to ten percent of the swap market.

The objective of corporates are really just to mitigate their risk and try to efficiently manage that risk and look at the portfolio. My fear is if there is this margin requirement that it will cause companies to move away from it and not manage their risks, thereby increasing their risk in the marketplace.

Mr. COLBY. In terms of the cost side of that question, diverting cash flow from a company's business operations where we can create jobs and protect jobs and generate a good return for shareholders is very costly. There is a high-opportunity cost that in our opinion outweighs the small credit mitigation benefits of posting margin.

As Chairman Gensler indicated, commercial end-users represent nine percent of the OTC market, but we create 94 percent of the jobs. So the margin bill is going to very slightly impact the 90 percent but potentially significantly impact the 94 percent, which is the one that I think that we care about.

Mr. AUSTIN SCOTT of Georgia. Yes, sir, and Mr. Colby, you bring up an important point there, and 27 months ago I was in the private sector, and you used two words up here that we don't hear much from regulators, and that is cash flow, and certainly in the private sector we can't use the same dollar twice at the same time, can we? And that it——

Mr. COLBY. No, we can't.

Mr. AUSTIN SCOTT of Georgia. And I think that is where the real issue comes in and where we can help America's economy by making sure that the end-user is not subject to that extra cost because every dollar that is locked up is a dollar that can't be used to expand your business and put Americans back to work, and our goal is to help you get Americans back to work.

So thank you so much, and Mr. Chairman, I yield the remainder of my time.

The CHAIRMAN. The gentleman's time has expired.

Mr. DAVID SCOTT of Georgia. Mr. Chairman.

The CHAIRMAN. Does the gentleman have a request?

Mr. DAVID SCOTT of Georgia. Yes. I would like to ask for 1 minute if I could. I wanted to get Mr. Turbeville's response to my question on speculation.

The CHAIRMAN. Seeing no objection, the chair yields the gentleman 1 minute that he therefore yields to the witness.

Mr. DAVID SCOTT of Georgia. Thank you very much, sir.

Mr. TURBEVILLE. Thank you. The question really is about speculative activity in the futures and swaps markets as it relates to prices on delivery swap prices, and the connection between the two has to do with the fact that in the futures market or in the swaps market you are creating a forward curve which is the expectation that prices are going to rise, fall, or stay the same.

There is no question that if speculative activity changes the forward curve for prices it will change spot prices. For instance, if it appears that the prices are going to rise over time, then spot prices will go up as well as people withhold from the market waiting for the prices to rise later. If prices are going to fall, people will put more supply into the market. So there is no question about that.

My colleague here, Mr. Bentsen, said there were many studies that didn't find any connection, and that is like saying that there are many studies that didn't find Pluto until they found Pluto. Once you find Pluto, you got Pluto, the planet, not the dog.

So there have been studies that have found connections. I participated in one that found a connection, and my particular study that I looked at asked the following questions. Commodity index funds, if you are familiar with those, which there is these huge commodity index funds that sort of die and recreate themselves every month in effect. So all of their futures get sold off, then they buy longer-dated futures, and what we took a look at is whether there was a connection between that period where they do that lengthening of their positions and they put pressure on the out-years, does that actually cause the forward curve to go up, or does it have an influence on the forward curve going up? And we found that for several commodities, oil, some of the grains there was a correlation of 99.9 percent of that rollover period with upward movement pressures on the forward curve. Upper movement pressures on the forward curves means the spot prices are likely to go up.

So the answer is there has been some good work done on it. It is hard to measure, but there has been a measurement of it, and I think that the real conclusion should be perhaps it is how much speculation but the easier thing to find the connection with this is what kind of speculation. If you do something every month that pushes, puts pressure out on the forward curve causing it to go up, then you are going to affect spot prices.

Mr. DAVID SCOTT of Georgia. Thank you.

The CHAIRMAN. The gentleman's minute has expired.

The chair now recognizes the gentleman from Tennessee, Mr. Fincher, for 5 minutes.

Mr. FINCHER. Thank you, Mr. Chairman. Following up with that, when you said the rollover, are you talking about getting out of the positions and getting longer positions in the market?

Mr. TURBEVILLE. That is correct. What happens is a bank like Goldman Sachs, which is one of the major players, has done a swap with somebody like a pension fund or a university fund, and the swap is all about the price of futures.

Mr. FINCHER. Right.

Mr. TURBEVILLE. And what they are doing is they are financializing. They are creating a synthetic ownership of oil, corn, wheat, soybeans, everything else. Synthetic ownership on the part of these funds. But to create the synthetic ownership the bank then has to go out into the market and——

Mr. FINCHER. Right.

Mr. TURBEVILLE.—replicate that and roll it over every month.

Mr. FINCHER. To stay in the market. To stay——

Mr. TURBEVILLE. That is right. So futures expire. This is like ownership which is permanent. So what happens is that the roll-over puts pressure on the out-years of the market, which causes, the technical term is causes the forward curve to go more into contango, being more forced up, and that has an effect on prices because people price over next month's forward price, and they have index contracts, Platts, who has oil price index, references that contract, and just commonsense tells you that you are going to look out there. And I am actually from Tennessee.

Mr. FINCHER. All right. Well, the issue I have, and I have a couple of questions for Mr. Bentsen and Ms. Hollein also, but the two words and being from the private sector and a large family farm background and have done a lot of marketing and used derivatives often, is are the unintended consequences that go with more government and more regulation, and the things that it will do to the market as we are starting to learn as we get into Title VII even more.

If you, in my opinion, again, knowing the details of a lot of this, if you try to take all of the risks out of the market, then you have no market. You will destroy the market completely, and there is a certain amount of risk that you are going to have. We have to take positions on everything now to make sure we are hedged in order to stay in business.

But to Mr. Bentsen, section 716 would negatively affect uninsured depository institutions such as many foreign banks that operate branches in the United States.

Would the credit availability from these institutions be impacted if section 716 is fully implemented, and why or why not?

Mr. BENTSEN. Mr. Fincher, I think that the biggest problem with section 716, I will come back to your point, in our view and I think this is where Chairman Bernanke is coming from and I think this is where then Chairwoman Bair was coming from is that you are taking capital out of the bank, and you are putting it into an affiliate and shifting part of the activity which otherwise has been under their jurisdiction and prudential jurisdiction and supervision. And so you are depleting, one, you are depleting capital from the entity that you are regulating, and then you are creating a separate affiliate that you may not have primary supervision over.

And so I think that is where their primary concern is. So that is why on the whole our view is that section 716 and their view is that section 716 doesn't work and doesn't make sense, and I might just add, one thing that Chairman Gensler said that he thinks it is probably going to come into effect in a year or in 2 years. It actually is supposed to come into effect on July 21 of this year, but there has been no proposed rulemaking, and in fact, the OCC just recently put out a request, sort of guidance with the request for firms who would be subject to it to ask for an extension. They do have a conformance or an extension period.

To your point with respect to the foreign banks, the foreign branch operations, the way the law was crafted is that it applies to insured depository institutions. So if you are a foreign bank branch or agency that is not operating an insured bank in this country, then it is not at all clear how you are affected by this rule or not if you read literally off the statute. The Federal Reserve has some flexibility under some existing statutes, but it is not clear that they can make an adjustment.

But I think the main point is that this is something that causes depletion and shift of capital and really moves things out of more primary jurisdiction. Congress at the end kind of split the thing in half with some swaps in, some swaps out, and it really doesn't make any sense. And so that is why I think you are seeing the principle regulator saying this ought to be fixed.

Mr. FINCHER. Will H.R. 992 provide the fix?

Mr. BENTSEN. Yes. I think so.

Mr. FINCHER. Okay, and one more follow-up question to Ms. Hollein. Do you think end-users pose a systemic risk?

Ms. HOLLEIN. Do I think they cause systemic risk?

Mr. FINCHER. Do they pose a systemic risk to U.S. financial institute?

Ms. HOLLEIN. No. I do not believe they do at all. In fact, they are just mitigating their risk. They don't cause any systemic risk at all.

Mr. FINCHER. Okay. I yield back, Mr. Chairman. Thank you very much.

The CHAIRMAN. The gentleman yields back the balance of his time. That concludes our questions.

I would like to note for my colleagues that this has been a very worthwhile hearing. These are very important subject matters, and I would expect some time in the very near future we will move towards a legislative markup.

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

This hearing of the House Agriculture Committee is adjourned.

[Whereupon, at 12:30 p.m., the Committee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED LETTERS BY HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

March 13, 2013

Hon. RANDY HULTGREN,
U.S. House of Representatives,
Washington, D.C.;

Hon. JAMES HIMES,
U.S. House of Representatives,
Washington, D.C.;

Hon. RICHARD HUDSON,
U.S. House of Representatives,
Washington, D.C.;

Hon. SEAN PATRICK MALONEY,
U.S. House of Representatives,
Washington, D.C.

Dear Reps. Hultgren, Himes, Hudson, and Maloney:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses and organizations of every size, sector, and region, supports H.R. 992 and S. 474, the Swaps Regulatory Improvement Act. This bipartisan, bicameral legislation would serve to promote vibrant and efficient capital markets by modifying section 716 of the Dodd-Frank Act, a provision that undermines the Act's central policy objective of mitigating systemic risk.

When section 716—often referred to as the swaps push-out provision—was enacted, its proponents described it as "quarantining highly risky swaps activity." The provision attempts to accomplish this objective by requiring that insured depository institutions spin-off certain derivatives activities (*e.g.,* commodity derivatives that agricultural market participants use to reduce risk) into separately capitalized affiliates of an insured depository institution.

However, contrary to its objectives, section 716 would increase risk for derivatives market participants, while at the same time driving up costs. It would do so by requiring market participants to transact with multiple entities within the same banking organization, which would create new risks for market participants because it would eliminate their ability to net multiple contracts into a single obligation. Additionally, it would add cost and complexity by requiring market participants to put in place multiple agreements and make multiple settlements on their derivatives transactions.

Such outcomes would disrupt aspects of the derivatives market that work well and that played no role in the financial crisis. Indeed, market participants have implemented these practices to reduce risk. Additionally, section 716 would weaken prudential regulation by shifting activities to entities that are not prudentially regulated.

These are among the reasons international regulators have refrained from introducing or implementing similar provisions in their own regulatory regimes. Now more than 2½ years since Dodd-Frank was enacted, no government has followed America's lead in implementing a provision like section 716. Consequently, while serving no useful function, the provision threatens to undermine the competitiveness of U.S. capital markets.

The Chamber supports the Swaps Regulatory Improvement Act and looks forward to working with the Congress to ensure the U.S. maintains its position as the world leader in fair, efficient, and innovative capital markets.

Sincerely,

R. BRUCE JOSTEN.
Executive Vice President, Government Affairs,
U.S. Chamber of Commerce

March 7, 2013

Hon. RANDY HULTGREN,
U.S. House of Representatives,
Washington, D.C.

Dear Congressman Hultgren:

The Illinois Chamber of Commerce is writing in support of H.R. 992, a bipartisan bill that will help promote bank safety and soundness, limit the risks and costs associated with bank failure, and reduce Illinois businesses and agriculture producers cost of managing risk. We thank you for taking the lead on this important issue.

The Dodd-Frank "push-out" provision (Section 716), would prohibit bank entities from engaging in certain derivatives activities within the bank. By forcing these activities out of the bank, it complicates bank risk management activities and increases the cost of a potential bank resolution.

For these reasons, several current and former bank regulators, including Federal Reserve Chair Ben Bernanke, former FDIC-Chair Sheila Bair, and former Federal Reserve Chairman Paul Volcker, expressed concerns with this provision of Dodd-Frank.

Your bill will reduce these risks, while at the same time, ensuring that banking activities cannot engage in the riskiest types of derivatives activities. By doing so, it achieves a common sense balance of allowing banks to service their customers' needs, while protecting bank safety and soundness. For this reason, we commend you on this bipartisan legislation.

Sincerely,

Todd C. Maisch

TODD MAISCH,
Executive Vice President,
Illinois Chamber of Commerce.

February 6, 2013

Hon. GARY GENSLER,
Chairman,
U.S. Commodity Futures Trading Commission,
Washington, D.C.

Re: Further Proposed Guidance Regarding Compliance With Certain Swap Regulations

Dear Gary,

We appreciate the opportunity to comment on the further proposed guidance regarding compliance with certain swap regulations. We are writing to ask the Commission's consideration of our general and three specific comments with respect to (i) exclusion from aggregation of U.S. and non-U.S. affiliates' transactions with U.S. persons for the purposes of the *de minimis* test for a non-U.S. person, (ii) clarification of the scope and definition of U.S. person, and (iii) flexibility in the expiration of the final exemptive order.

I. General Comment

We appreciate the Commission's effort to provide market participants with as much clarity as possible on (i) the aggregation rule for *de minimis* threshold for a non-U.S. person and (ii) the scope and definition of U.S. person in the final exemptive order published on December 21, 2012. However, we are concerned that the alternative interpretation on the aggregation rule and the scope and definition of U.S. person in the further proposed guidance would make the scope of application of the Commission's regulations broader for non-U.S. persons. Since we believe that the scope of application on those two matters in the final exemptive order is acceptable, we would like to request the Commission to adopt this exemptive order as the permanent one, after the order expires in July 2013.

II. Specific Comments

In addition to this general comment, we have three specific comments on the further proposed guidance as follows.

1. Exclusion From Aggregation of U.S. and Non-U.S. Affiliates' Transactions With U.S. Persons for the *De Minimis* Test for a Non-U.S. Person

Under the further proposed guidance, a non-U.S. person would be required, in determining whether its swap dealing transactions exceed the *de minimis* threshold, to include the aggregate notional value of swap dealing transactions entered into by all its affiliates under common control (*i.e.,* both non-U.S. affiliates and U.S. affiliates), but would not be required to include in such determination the aggregate notional value of swap dealing transactions of any non-U.S. affiliate under common control that is registered as a swap dealer.

As far as the Japanese financial institutions are concerned, we believe that they should not be required to include the aggregate notional value of swap dealing transactions entered into by all their U.S. affiliates, and non-U.S. affiliates under common control that are not registered as swap dealers, in addition to any non-U.S. affiliate that is registered as a swap dealer, since those affiliates are supervised by FSA Japan on a consolidated basis.

In particular, since both U.S. and non-U.S. affiliates registered as swap dealers would be subject to the Commission's regulations and supervision, their transactions with U.S. persons should be excluded for *de minimis* test for the non-U.S. person.

2. Clarification of the Scope and Definition of U.S. Person

We appreciate the Commission's effort to narrow the scope and definition of U.S. person in the final exemptive order, compared with that of the proposed interpretive guidance of July 2012.

Furthermore, the proposed interpretive guidance correctly states that a foreign affiliate or subsidiary of a U.S. person would be considered a non-U.S. person, even where such an affiliate or subsidiary has certain or all of its swap-related obligations guaranteed by the U.S. person. However, it is not clear to us in this regard whether the further proposed guidance maintains this interpretation. We think the interpretation adopted in the proposed interpretive guidance is adequate, because non-U.S. affiliates of the U.S. person established under the law of foreign countries are under regulation and supervision by foreign regulators. We would like to confirm that this interpretation holds valid under the further proposed guidance.

3. Flexibility in the Expiration of the Final Exemptive Order

We understand that the Commission intends to conduct assessment for substituted compliance with foreign regulatory requirements before the expiration date (July 12, 2013) of the final exemptive order. If, at the expiration date, substituted compliance with the Japanese regulatory requirements is not available for Japanese financial institutions which registered as swap dealers, they would be subject to the Commission's regulations after the expiration date. This is not acceptable to us. Therefore, we would like to urge the Commission to consider extending the effectiveness of the final exemptive rule, depending on whether and when such substituted compliance would be available.

We would like to kindly request that the Commission take into account the above and amend the further proposed guidance in accordance with our requests. Should you have any questions concerning the above, please do not hesitate to contact us.

Sincerely yours,

河野正道 M.K

MASAMICHI KONO,
Vice Commissioner for International Affairs,
Financial Services Agency,
Government of Japan.

CC:

Commissioner Ms. JILL E. SOMMERS, CFTC;
Commissioner Mr. BART CHILTON, CFTC;
Commissioner Mr. SCOTT D. O'MALIA, CFTC;
Commissioner Mr. MARK P. WETJEN, CFTC;
Chairman ELISSE B. WALTER, SEC;
Under Secretary for International Affairs LAEL BRAINARD, U.S. Department of the Treasury.

SUBMITTED LETTERS BY HON. RICHARD HUDSON, A REPRESENTATIVE IN CONGRESS FROM NORTH CAROLINA

May 12, 2010

Hon. CHRISTOPHER J. DODD,
Chairman,
Senate Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

Dear Mr. Chairman:

You have asked for my views on section 716 of S. 3217. This section would prevent many insured depository institutions from engaging in swaps-related activities to hedge their own financial risks or to meet the hedging needs of their customers, and would prohibit non-bank swaps entities, including swap dealers, clearing agencies and derivative clearing organizations, from receiving any type of Federal assistance.

The Federal Reserve has been a strong proponent of changes to strengthen the regulatory framework and infrastructure for over-the-counter (OTC) derivative markets to reduce systemic risks, promote transparency, and enhance the safety and soundness of banking organizations and other financial institutions. Title VII and Title VIII of S. 3217 include important provisions designed to achieve these goals. For example, Title VII would require most derivative contracts to be cleared through central clearinghouses and traded on exchanges or open trading facilities, require information concerning all other derivatives contracts to be reported to trade repositories or regulators, and provide the regulatory agencies significant new authorities to ensure that all swaps dealers and major swap participants are subject to strong capital, margin, and collateral requirements with respect to their swap activities. Title VIII also includes provisions designed to help ensure that centralized market utilities for clearing and settling payments, securities, and derivatives transactions (financial market utilities), which are critical choke points in the financial system, are subject to robust and consistent risk management standards—including collateral, margin, and robust private-sector liquidity arrangements—and do not pose a systemic risk to the financial system.

I have also frequently made clear that we must end the notion that some firms are "too-big-to-fail." For that reason, the Federal Reserve has advocated the development of enhanced and rigorous prudential standards for all large, interconnected financial firms, and the enactment of a new resolution regime that would allow systemically important financial firms to be resolved in an orderly manner, with losses imposed on the Federal Reserve to provide emergency, secured credit to nondepository institutions only through broad-based liquidity facilities designed to address serious strains in the financial markets, and not to bail out any specific firm.

S. 3217 makes important contributions to the goals of reducing systemic risk, eliminating the too-big-to-fail problem, and strengthening prudential supervision. I am concerned, however, that section 716 is counter-productive to achieving these goals.

In particular, section 716 would essentially prohibit all insured depository institutions from acting as a swap dealer or a major swap participant—even when the institution acts in these capacities to serve the commercial and hedging needs of its customers or to hedge the institution's own financial risks. Forcing these activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities.

Prohibiting depository institutions from engaging in significant swaps activities will weaken the risk mitigation efforts of banks and their customers. Depository institutions use derivatives to help mitigate the risks of their normal banking activities. For example, depository institutions use derivatives to hedge the interest rate, currency, and credit risks that arise from their loan, securities, and deposit portfolios. Use of derivatives by depository institutions to mitigate risks in the banking business also provides important protection to the deposit insurance fund and taxpayers as well as to the financial system more broadly. In addition, banks acquire substantial expertise in assessing and managing interest rate, currency, and credit risk in their ordinary commercial banking business. Thus, banks are well situated to be efficient and prudent providers of these risk management tools to customers.

Importantly, banks conduct their derivatives activities in an environment that is subject to strong prudential Federal supervision and regulation, including capital regulations that specifically take account of a bank's exposures to derivative transactions. The Basel Committee on Banking Supervision has recently proposed tough new capital and liquidity requirements for derivatives that will further strengthen the prudential standards that apply to bank derivative activities. Titles I, III, VI, VII and VIII of S. 3217 all add provisions further strengthening the authority of the Federal banking agencies and other supervisory agencies to address the risks of derivatives. Section 716 would force derivatives activities out of banks and potentially into less regulated entities or into foreign firms that operate outside the boundaries of our Federal regulatory system. The movement of derivatives to entities outside the reach of the Federal supervisory agencies would increase, rather than reduce the risk to the financial system. In addition, foreign jurisdictions are highly unlikely to push derivatives business out of their banks. Accordingly, foreign banks will have a competitive advantage over U.S. banking firms in the global derivatives marketplace, and derivatives transactions could migrate outside the United States.

More broadly, section 716 would prohibit the Federal Reserve from lending to *any* swaps dealer or major swap participant—regardless of whether it is affiliated with a bank—even under a broad-based 13(3) liquidity facility in a financial crisis. Experience over the past 2 years demonstrates that such broad-based facilities can play a critical role in stemming financial panics and addressing severe strains in the financial markets that threaten financial stability, the flow of credit to households and businesses, and economic growth. These facilities will be less effective if participants must choose between continuing (or unwinding) derivatives positions and participating in the market-liquefying facility.

I am concerned that section 716 in its present form would make the U.S. financial system less resilient and more susceptible to systemic risk and, thus, is inconsistent with the important goals of financial reform legislation. We look forward to continuing to work with the Congress as you work to enact strong regulatory reform legislation that both addresses the weaknesses in the financial regulatory system that became painfully evident during the crisis, and positions the regulatory system to meet the inevitable challenges that lie ahead in the 21st century.

Sincerely,

BEN S. BERNANKE,
Chairman,
Board of Governors of the Federal Reserve System.

May 6, 2010

Dear Mr. Chairman:

A number of people, including some Members of your Committee, have asked me about the proposed restrictions on bank trading in derivatives set out in Senator Lincoln's proposed amendment to Section 716 of S. 3217. I thought it best to write you directly about my reaction.

I well understand the concerns that have motivated Senator Lincoln in terms of the risks and potential conflicts posed by proprietary trading in derivatives concentrated in a limited number of commercial banking organizations. As you know, the proposed restrictions appear to go well beyond the proscriptions on proprietary trading by banks that are incorporated in Section 619 of the reform legislation that you have proposed. My understanding is that the prohibition already provided for in Section 619, specifically including the Merkley-Levin amended language clarifying the extent of the prohibition on proprietary trading by commercial banks, satisfy my concerns and those of many others with respect to bank trading in derivatives.

In that connection, I am also aware of, and share, the concerns about the extensive reach of Senator Lincoln's proposed amendment. The provision of derivatives by commercial banks to their customers in the usual course of a banking relationship should not be prohibited.

In sum, my sense is that the understandable concerns about commercial bank trading in derivatives are reasonably dealt with in Section 619 of your reform bill as presently drafted. Both your Bill and the Lincoln amendment reflect the important concern that, to the extent feasible, derivative transactions be centrally cleared or traded on a regulated exchange. These are needed elements of reform.

I am sending copies of this letter to Secretary Geithner and to Senators, Shelby, Merkley, Levin and Lincoln.

Sincerely,

Paul

PAUL A. VOLCKER.

April 30, 2010

Hon. CHRISTOPHER J. DODD,
Chairman,
Senate Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.;

Hon. BLANCHE L. LINCOLN,
Chairman,
Senate Committee on Agriculture, Nutrition, and Forestry,

Washington, D.C.

Dear Chairman Dodd and Chairman Lincoln:

Thank you for reaching out to the Federal Deposit Insurance Corporation for our views on Title VII of the "Wall Street Transparency and Accountability Act" contained in S. 3217, the "Restoring American Financial Stability Act of 2010." At the outset, I would like to express my strong support for enhanced regulation of "over-the-counter" (OTC) derivatives and the provisions of the bill which would require centralized clearing and exchange trading of standardized products. If this requirement is applied rigorously it will mean that most OTC contracts will be centrally cleared, a desirable improvement from the bilateral clearing processes used now. I would also like to express my wholehearted endorsement of the ultimate intent of the bill, to protect the deposit insurance fund from high risk behavior.

I would like to share some concerns with respect to section 716 of S. 3217, which would require most derivatives activities to be conducted outside of banks and bank holding companies. If enacted, this provision would require that some $294 trillion in notional amount of derivatives be moved outside of banks or from bank holding companies that own insured depository institutions, presumably to non-bank financial firms such as hedge funds and futures commission merchants, or to foreign banking organizations beyond the reach of Federal regulation. I would note that credit derivatives—the riskiest—held by banks and bank holding companies (when measured by notional amount) total $25.5 trillion, or slightly less than nine percent of the total derivatives held by these entities.

At the same time, it needs to be pointed out that the vast majority of banks that use OTC derivatives confine their activity to hedging interest rate risk with straightforward interest rate derivatives. Given the continuing uncertainty surrounding future movements in interest rates and the detrimental effects that these could have on unhedged banks, I encourage you to adopt an approach that would allow banks to easily hedge with OTC derivatives. Moreover, I believe that directing standardized OTC products toward exchanges or other central clearing facilities would accomplish the stabilization of the OTC market that we seek to enhance, and would still allow banks to continue the important market-making functions that they currently perform.

In addition, I urge you to carefully consider the underlying premise of this provision—that the best way to protect the deposit insurance fund is to push higher risk activities into the so-called shadow sector. To be sure, there are certain activities, such as speculative derivatives trading, that should have no place in banks or bank holding companies. We believe the Volcker rule addresses that issue and indeed would be happy to work with you on a total ban on speculative trading, at least in the CDS market. At the same time, other types of derivatives such as customized interest rate swaps and even some CDS do have legitimate and important functions as risk management tools, and insured banks play an essential role in providing market-making functions for these products.

Banks are not perfect, but we do believe that insured banks as a whole performed better during this crisis because they are subject to higher capital requirements in both the amount and quality of capital. Insured banks also are subject to ongoing prudential supervision by their primary banking regulators, as well as a second pair of eyes through the FDIC's back up supervisory role, which we are strengthening as a lesson of the crisis. If all derivatives market-making activities were moved outside of bank holding companies, most of the activity would no doubt continue, but in less regulated and more highly leveraged venues. Even pushing the activity into a bank holding company affiliate would reduce the amount and quality of capital required to be held against this activity. It would also be beyond the scrutiny of the FDIC because we do not have the same comprehensive backup authority over the affiliates of banks as we do with the banks themselves. Such affiliates would have to rely on less stable sources of liquidity, which—as we saw during the past crisis—would be destabilizing to the banking organization in times of financial distress, which in turn would put additional pressure on the insured bank to provide stability. By concentrating the activity in an affiliate of the insured bank, we could end up with less and lower quality capital, less information and oversight for the FDIC, and potentially less support for the insured bank in a time of crisis. Thus, one unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund, which I know is not the result any of us want.

A central lesson of this crisis is that it is difficult to insulate insured banks from risk taking conducted by their non-banking affiliated entities. When the crisis hit, the shadow sector collapsed, leaving insured banks as the only source of stability. Far from serving as a source of strength, bank holding companies and their affiliates had to draw stability from their insured deposit franchises. We must be careful not to reduce even further the availability of support to insured banks from their holding companies. As a result, we believe policies going forward should recognize the damage regulatory arbitrage caused our economy and craft policies that focus on the quality and strength of regulation as opposed to the business model used to support it.

The FDIC is pleased to continue working with you on this important issue to assure that the final outcome serves all of our goals for a safer and more stable financial sector. We hope that a compromise can be achieved by perhaps moving some derivatives activity into affiliates, so long as capital standards remain as strict as they are for insured depositories and banks continue to be able to fully utilize derivatives for appropriate hedging activities.

Please do not hesitate to contact me at [**Redacted**] or have your staff contact Paul Nash, Deputy Director for External Affairs, at [**Redacted**].

Sincerely,

Sheila C Bair

SHEILA C. BAIR,
Chairman,
Federal Deposit Insurance Corporation.

EXCERT FROM H. REPT 112–476

MINORITY VIEWS

The Wall Street Reform and Consumer Protection Act requires, for the first time, the regulation of over-the-counter derivatives, previously opaque transactions that helped bring our financial system to the brink of disaster. The vast majority of derivatives must now be centrally cleared and publicly reported, and be backed by margin and capital to ensure that swap dealers and major swap users can honor their commitments. In addition, the reform law also prohibits banks from placing bets with federally insured deposits through the "Volcker Rule". Both measures serve as important safeguards as we rebuild trust in our financial system.

As amended, H.R. 1838 would repeal portions of Section 716 of the financial reform law, also known as the "push-out provision." Section 716 prohibits banks from engaging in several types of derivatives. Questions have been raised about this provision by economists and regulators including FDIC's Sheila Bair, who are concerned that it might interfere with a bank's ability to use derivatives to diminish risk. Section 716 was not part of the original House-passed version of the financial reform law.

During the Full Committee markup, Democrats worked with the Majority to amend H.R. 1838 to continue the prohibition of complex swaps employed by AIG with devastating effect. H.R. 1838, as amended, addresses the valid criticisms of Section 716 without weakening the financial reform law's important derivative safeguards or prohibitions on bank proprietary trading.

BARNEY FRANK.
WM. LACY CLAY.
GWEN MOORE.
JAMES A. HIMES.
RUBÉN HINOJOSA.
ANDRÉ CARSON.
GARY L. ACKERMAN.
AL GREEN.
STEPHEN F. LYNCH.
DAVID SCOTT.
MAXINE WATERS.
CAROLYN B. MALONEY.
MELVIN L. WATT.
LUIS V. GUTIERREZ.
GARY C. PETERS.
ED PERLMUTTER.
MICHAEL E. CAPUANO.
GREGORY W. MEEKS.

Response from Hon. Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission

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

Question 1. Chairman Gensler, in June of 2011, CFTC proposed a rule that would have required companies that have a futures exchange membership to record all oral and written communication regarding futures and related cash commodity trades and retain those communications for 5 years. In your final rule, the CFTC excluded members of a DCM—that are not otherwise registered with either the CFTC or NFA—from the oral recording requirements. If the appropriate policy regarding members of a DCM—that are not otherwise required to be registered with the CFTC—is to not require recording of oral communications related to cash commodity sales, are they required to retain the 21st century analogs for oral conversation, such as text messages and instant messages?

Answer. In 2009, the Commission's Division of Market Oversight (DMO) issued an Advisory to clarify certain Commission record-keeping requirements pertaining to futures commission merchants (FCMs), introducing brokers (IBs), and members of a designated contract market. The Advisory was to clarify that the individuals and entities subject to the Commission's record-keeping requirements should maintain all electronic forms of communications, including email, instant messages, and any other form of communication created or transmitted electronically for all trading. Also noted in the Advisory is that record-keeping regulations do not distinguish between methods used to record the information covered by the regulations, including e-mails, instant messages, and any other form of communication created or transmitted electronically. The Commission adopted the proposed amendment to regulation 1.35(a) to clarify that the existing requirement to keep written records applies to electronic written communications, such as emails and instant messages.

The amended regulation provides that among the records required to be kept are all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and related cash or forward transactions, whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device, or other digital or electronic media. The final rule does not specifically include "voicemail" in the category of written communication but provides a list of included modes of communication in the requirement that "all oral and written communications" be kept.

Question 2. It is my understanding that text messaging and instant messaging are difficult, if not impossible, for a company to capture and retain, especially with respect to mobile devices, which have proprietary software and operate on proprietary networks. If they are required to keep text messages and other non-verbal communications in order to comply with the final rule as written, employees of companies will have no choice but to avoid text and instant messaging, and simply go back to using the phone, which they do not have to record. Is this the policy outcome that you envisioned under the final rule?

Answer. Commission staff are aware that there are companies that have been offering technological solutions for entities to capture and retain IMs and text messages.

The overarching purpose of the Commission's final rule is to promote market integrity and protect customers. Requiring the recording and retention of oral communications will serve as a disincentive for covered entities to make fraudulent or misleading communications. The Commission received comments regarding the cost of implementing and maintaining an oral communication recording system for small entities and the commercial end-user, non-intermediary members of a DCM or SEF. In response the Commission determined to exclude from the new oral communications requirement members that are not registered or required to be registered with the Commission in any capacity.

Questions Submitted By Hon. Jeff Denham, a Representative in Congress from California

Question 1. Congress enacted Dodd-Frank to reform oversight of big financial firms. Do you think it is appropriate for the CFTC's regulatory reach to extend into the day-to-day operational transactions of electric utilities?

Question 2. Municipal utilities have laid out a compelling case that the entity definitions rule is flawed and creates unintended consequences for the electric sector. Why can't you fix this at the regulatory level?

Answer 1–2. The final rule adopted jointly by the CFTC and the SEC to further define the term "swap dealer" provides that a person shall not be deemed a swap dealer if swap dealing activity for the preceding 12 months results in swap positions with an aggregate gross notional amount of no more than $3 billion, and an aggregate gross notional amount of no more than $25 million with regard to swaps with a "special entity" (which includes municipalities, other political subdivisions and employee benefit plans). The rule also provides for a phase-in of the *de minimis* threshold to facilitate orderly implementation of swap dealer requirements. During the phase-in period, the *de minimis* threshold would effectively be $8 billion (while the $25 million threshold for swaps with special entities would apply).

In developing the rule further defining the term "swap dealer" and other rules under the Dodd-Frank Act that may affect municipal utilities, CFTC Commissioners and staff met with municipal utility representatives and their advisors and counterparties regarding their concerns. The final joint rule contains a provision that excludes from the calculation certain swaps entered into for the purpose of hedging physical positions. In addition, on October 12, 2012, Commission staff issued no-action relief, which states that staff will not recommend enforcement action if non-financial entities enter into swaps as part of a swap dealing business with utility special entities (such as municipal utilities) with a notional value of up to $800 million annually without registering as a swap dealer. By its terms, the no-action relief will remain in effect until Commission action is completed on a petition submitted by public utilities requesting an amendment to the rule to exclude from the special entity *de minimis* threshold relevant swap contracts relating to utility operations.

Congress also authorized the CFTC to provide relief from the Dodd-Frank Act's swaps reforms for certain electricity and electricity-related energy transactions between rural electric cooperatives and federal, state, municipal and tribal power authorities. Similarly, Congress authorized the CFTC to provide relief for certain transactions on markets administered by regional transmission organizations and independent system operators. The Commission recently finalized exemptive orders related to these transactions, as Congress authorized.

Question 3. Chairman why do you believe Swap Execution Facilities (SEFs) should require five (5) Requests for Quotes (RFQs) when the SEC has an alternate proposal that does not include this mandatory requirement?

Answer. On May 16, 2013, the Commission approved the final rulemaking on swap execution facilities (SEFs). This rule is key to fulfilling transparency reforms that Congress mandated in the Dodd-Frank Act.

The Dodd-Frank Act included a trade execution requirement for swaps. Swaps subject to mandatory clearing and made available to trade were to move to transparent trading platforms. Market participants will benefit from the price competition that comes from trading platforms where multiple participants have the ability to trade swaps by accepting bids and offers made by multiple participants. Congress also said that the market participants must have impartial access to these platforms.

Farmers, ranchers, producers and commercial companies that want to hedge a risk by locking in a future price or rate will get the benefit of the competition and transparency that trading platforms, both SEFs and designated contract markets (DCMs), will provide.

These transparent platforms will give everyone looking to compete in the marketplace the ability to see the prices of available bids and offers prior to making a decision on a transaction. By the end of this year, a significant portion of interest rate and credit derivative index swaps will be in full view to the marketplace before transactions occur. This is a significant shift toward market transparency from the *status quo.*

Such common-sense transparency has existed in the securities and futures markets since the historic reforms of the 1930s. Transparency lowers costs for investors, businesses and consumers, as it shifts information from dealers to the broader public. It promotes competition and increases liquidity.

As Congress made clear in the law, trading on SEFs and DCMs would be required only when financial institutions transact with financial institutions. End-users would benefit from access to the information on these platforms, but would not be required to use them.

Further, companies would be able to continue relying on customized transactions—those not required to be cleared—to meet their particular needs, as well as to enter into large block trades.

Consistent with Congress' directive that multiple parties have the ability to trade with multiple parties on these transparent platforms, these reforms require that market participants trade through an order book, and provide the flexibility as well to seek requests for quotes.

To be a registered SEF, the trading platform will be required to provide an order book to all its market participants. This is significant, as for the first time, the broad public will be able to gain access and compete in this market with the assurance that their bids or offers will be communicated to the rest of the market. This provision alone will significantly enhance transparency and competition in the market.

SEFs also will have the flexibility to offer trading through requests for quotes. The rule provides that such requests will have to go out to a minimum of three unaffiliated market participants before a swap that is cleared, made available to trade and less than a block could be executed. There will be an initial phase-in period with a minimum of two participants to smooth the transition.

As long as the minimum functionality is met, as detailed in the rule, and the SEF complies with these rules and the core principles, the SEF can conduct business through any means of interstate commerce, such as the Internet, telephone or even the mail. In this way, the rule is technology neutral.

Under these transparency reforms coupled with the Commission's rule on making swaps available for trading, the trade execution requirement will be phased in for market participants, giving them time to comply.

These reforms benefited from extensive public comments. Moving forward, the CFTC will work with SEF applicants on implementation.

Response from Hon. Kenneth E. Bentsen, Jr., Acting President and Chief Executive Officer, Securities Industry and Financial Markets Association

Question Submitted By Hon. Jeff Denham, a Representative in Congress from California

Question. Mr. Bentsen what are your concerns regarding the CFTC's cross-border guidance? Will it negatively affect the marketplace?

Answer. Following the March 14, 2013 House Committee on Agriculture hearing, you inquired what SIFMA's concerns were regarding the CFTC's cross-border guidance, and whether the guidance would negatively affect the marketplace.

While SIFMA supports many of the stated goals of Title VII of the Dodd Frank Act, we have serious concerns regarding the approach the CFTC has taken with regard to the cross-border application of the derivatives regulatory regime. I appreciate this opportunity to elaborate on the position of SIFMA and its member firms.

Though Title VII was signed into law 2½ years ago, we still do not know which swaps activities will be subject to U.S. regulation and which will be subject to foreign regulation. Of specific concern is the CFTC's release of multiple proposed definitions of "U.S. Person." These "U.S. Person" definitions are very broad and give rise to concerns that CFTC regulation may be applied to persons with minimal jurisdictional nexus to the United States. This has consequently created a great deal of ambiguity and confusion for market participants as they try to determine their "U.S. Person" status and that of their counterparties, along with any accompanying regulatory obligations. SIFMA has advocated for a final definition of "U.S. Person" that focuses on significant, rather than nominal, connections to the United States and is simple, objective and transparent enough for a person to determine its status and the status of its counterparties on an ongoing basis.

The CFTC has not adequately coordinated with other domestic and international regulators regarding the definition of "U.S. Person" and the scope of its extraterritorial jurisdiction. We are also concerned with the CFTC's proposed approach to comparing foreign-country regulation with U.S. regulation. This proposed approach involves a determination by the Commission of the comparability and comprehensiveness of the rules relating to swaps activity on a rule-by-rule basis. SIFMA believes this goes far beyond any established regime and does not comport with established norms or comity.

Additionally, we have expressed concerns regarding the fact that the CFTC has issued its proposed cross-border releases as "guidance," rather than through a formal rulemaking process subject to the Administrative Procedure Act. By proposing guidance as opposed to a formal rule, the CFTC has avoided requirements to conduct the rigorous cost-benefit analysis critical to ensuring that the Commission appropriately weighs any costs imposed on market participants that may result from implementing an overly broad and complex cross-border regulatory regime.

With regard to the impact of the CFTC's cross-border guidance on the marketplace, SIFMA member firms have indeed witnessed instances of disruption. On October 12, 2012 (the date on which market participants began counting their swap dealing transactions to determine if they would be required to register with the CFTC), some counterparties outside of the U.S. refrained from entering into swap transactions with U.S. entities due to uncertainty in determining which transactions might subject the firm to CFTC registration. In light of this disruption, the CFTC issued numerous temporary no-action relief letters and other documents in an effort to assuage market concerns but this process was completed in a haphazard and last-minute manner. Notwithstanding the relief that has been issued to date by the CFTC, there remains significant uncertainty in the international marketplace due to the confusing and short-term nature of the CFTC's actions and public statements by CFTC officials.

Due to these conditions, concern over the cross-border reach of the CFTC has generated the great risk of driving the swaps market and related business out of the U.S. Such a migration could result in a decrease in the availability of hedging instruments and an increase in transaction costs for corporations and other Main Street end-users seeking to manage risk.

Response from James E. Colby, Assistant Treasurer, Honeywell International Inc.

Question Submitted By Hon. Marcia L. Fudge, a Representative in Congress from Ohio

Question. Dodd-Frank has been largely silent on the regulatory treatment of inter-affiliate swaps. As a result, some are concerned that the Commodity Futures Trading Commission may treat inter-affiliate transactions as it treats other swaps by subjecting them to clearing, execution and margin requirements. Why is it important to clarify that inter-affiliate swaps be treated differently than market-facing swaps? What negative impacts will be seen by end-users if no clarification is given?

Answer. Commercial end-users frequently utilize a hedging model incorporating centralized treasury units. Under this model, a company's affiliates will hedge their exposures with the centralized treasury unit, which will net these exposures (because many affiliates' exposures will offset one another) and hedge the company's net exposure by executing market-facing swaps with banks. The centralized treasury unit model significantly lowers both the number and notional value of a company's externally-facing derivatives transactions and materially reduces a company's hedging costs and bank credit line requirements. Consolidating all market-facing transactions within one entity makes it much easier to ensure that market-facing transactions are executed by experienced staff and greatly improves controls around derivatives transactions.

Centralized treasury units that are organized as a separate legal entity within the structure of a non-financial end-user might be considered persons engaged in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956. These centralized treasury units could be considered Financial Entities under Dodd-Frank and, without the clarification provided under H.R. 677, could be denied the clearing exception simply because they employ an efficient centralized treasury unit approach that reduces costs and mitigates systemic risk.

Response from Terrance P. Naulty, General Manager and Chief Executive Officer, Owensboro Municipal Utilities; Member, American Public Power Association

Questions Submitted By Hon. Jeff Denham, a Representative in Congress from California

Question 1. How familiar is your utility with transactions that hedge the operational risk of fuel costs , which affect the entire business model of municipal utilities in my Congressional district, such as Modesto Irrigation District and Turlock Irrigation District?

Answer. I am very familiar with these types of fuel hedging transactions. They are critical to managing fuel price risk and, ultimately, to maintaining stability of electric rates to consumers. Specifically, for public power utilities that use natural gas as a fuel for generation of electric energy, the ability to "lock in" the price of fuel is absolutely essential. As your question notes, Modesto Irrigation District and Turlock Irrigation District both rely on natural gas a fuel for electric generation.

By way of background, a public power utility will generally establish a fixed electric rate for consumers. As a result, the utility is contractually obligated to sell electricity at this fixed price for some period of time in the future. Without the ability to hedge (or purchase) the associated natural gas quantity for the corresponding period of time, the price risk imposed on the public power utility is not prudent. Thus, most utilities use financial instruments to fix the price of natural gas for such future deliveries. Doing so gives the utility certainty on what it will cost to produce the power and thus insure sufficient revenues to meet their expenses.

For utilities that burn coal or use uranium for electric generation, generally the use of financial instruments to fix the future price is not as important today because these fuels do not have the same level of price volatility as natural gas. In part because of this price stability, coal and uranium purchases are normally done through long-term physical contracts. However, as is the case with Owensboro Municipal Utilities, obtaining price certainty—through financial hedging—for surplus electrical generation from whatever fuel source is critical to maintaining stable and low electric rates to our customers.

As I pointed out in my testimony to the Committee, reducing a public power utility's access to the market place through the $25 million special entity sub-threshold limit imposed by the CFTC un-levels the playing field of the market. This is true whether the public power utility is hedging fuel price risk or power price risk. Again, suppliers that choose not to enter fuel price swap transactions with a public power utility to avoid being designated as a "swap dealer" represent a reduction in market liquidity to the public power utility. The public power utility must then turn to the smaller pool of financial entities for its fuel hedging business. These financial entities, with full understanding of these impacts, will have the ability to increase the bid/ask spread on these hedging instruments.

Thus, the affected public power utility rate payers ultimately will pay higher rates than they need to. To the extent that the public power utility has negotiated collateral limits with non-financial hedge counterparties that are now not willing to transact with them, there is a real potential that the public power utility will incur higher credit costs than needed. Again, these costs will be passed on to rate payers.

Entering into financial swap transactions with non-financial traders (many of whom are physical natural gas suppliers in the market) creates no incremental risk to the public power utility. The protections that the CFTC is trying to provide to these entities through the special entity sub-threshold are not needed and create real potential for higher electric rates with no reduction in risk.

Question 2. Does your utility engage in other types of financial transactions, such as speculation in the financial markets, that could increase your utility's risk of bankruptcy?

Answer. No. Owensboro Municipal Utilities uses financial swaps solely to hedge price risk and manage cash flow. Under current CFTC regulations, limiting trading counterparties as a direct result of the sub-threshold imposed upon special entities actually increases our bankruptcy risk. This is because we can no longer rely upon the collateral arrangements that we painstakingly negotiated with our non-financial trading counterparties that do not want to be swap dealers. Currently we must provide cash margin as opposed to relying upon the strength of our balance sheet to meet our collateral obligations for hedge transactions. Large price movements in natural gas or electric futures that normally could be accommodated within the collateral limits we had negotiated may force liquidation of trades in order to avoid the immediate cash margining impacts to OMU. These forced liquidations would result in realized losses that otherwise could have been weathered under the terms of bilateral agreement with non-financial counterparties.

Response from Marie N. Hollein, C.T.P., President and Chief Executive Officer, Financial Executives International and Financial Executives Research Foundation; on behalf of Coalition for Derivatives End-Users

Questions Submitted By Hon. Marcia L. Fudge, a Representative in Congress from Ohio

Question 1. Dodd-Frank has been largely silent on the regulatory treatment of inter-affiliate swaps. As a result, some are concerned that the Commodity Futures Trading Commission may treat inter-affiliate transactions as it treats other swaps by subjecting them to clearing, execution and margin requirements. Why is it important to clarify that inter-affiliate swaps be treated differently than market-facing swaps? What negative impacts will be seen by end-users if no clarification is given?

Answer. The Coalition for Derivatives End-Users believes that regulation of inter-affiliate swaps should square with the economic reality that inter-affiliate swaps do not pose systemic risk and therefore should not be regulated the same as trades that do. Without clarification, certain end-users could be faced with clearing their internal, inter-affiliate swaps, despite the end-user exception from clearing granted under Dodd-Frank. Without the clarification provided under H.R. 677, end-users that structure using an efficient centralized treasury hedging unit could be forced to dismantle this central unit because it could be considered a "financial entity." These companies would be forced to abandon their business model of only having one street-facing entity handling swap transactions, which has become a best practice, leaving a system where their hundreds of affiliates would be trading directly with bank counterparties. The result would be a system that is more costly, less efficient, eliminating the benefits of centralizing expertise in the company. H.R. 677 is necessary as the CFTC final rule exempting inter-affiliate swaps from clearing does not fix the centralized treasury unit issue that the legislation seeks to address. If left un-addressed, some companies could be facing a disadvantage against their competitors who do not structure in the same way and do not have to clear their swaps transactions.

Question 2. Inter-affiliate swaps are a common accounting practice used by several American corporations in multiple sectors of our economy. These companies have decided that managing risk in this fashion is more efficient and cost-effective. In your testimony, you stated that approximately ¼ of the end-users your company surveyed executed swaps through an affiliate. What are the benefits to managing risk through inter-affiliate swaps?

Answer. Many companies find it more efficient to manage their risk centrally, to have one affiliate trading in the open market, instead of dozens or hundreds of affiliates making trades in an uncoordinated fashion. Using this type of hedging unit centralizes expertise, allows companies to reduce the number of trades with the street and improves pricing. These advantages led me to centralize the treasury function at Westinghouse while I was there.

Question 3. If the Inter-Affiliate Swaps Clarification Act was to be made law, what's the likelihood that more companies would look to manage risk through inter-affiliate swaps? Do you think there would be a significant increase in these kinds of transactions?

Answer. I believe that the trend is moving toward centralization because it is a best practice. Companies that may not use this model now, may want to do so in the future. Yet, if Title VII of the Dodd-Frank Act makes it more costly to operate in a centralized manner, companies may abandon their plans to move toward the type of centralized treasury unit that would not qualify for the end-user exception from clearing.

Question 4. Our bill last year was reported out of both this Committee and the House Financial Services Committee unanimously. That said, perhaps the only criticism we heard about the bill is that it applied to inter-affiliate trades made by bank swap dealers and major swap participants, and not just end-users. So we have amended our bill to make it clear that is does not apply to Wall Street Banks and major swap participants. Do you think that this year's version of our bill is sufficiently tailored to address the problems faced by end-users without creating a loophole that could be exploited by other market participants?

Answer. The Coalition for Derivatives End-Users fully supports H.R. 677, which would ensure that end-users can continue to use the end-user exception from clearing granted under Dodd-Frank regardless of their utilization of inter-affiliate swaps or a centralized treasury unit business model. In terms of preventing exploitation of the exemption provided under this legislation, both versions—last Congress and this Congress—included a specific grant of anti-evasion authority to regulators to prevent abuse. This year's version of the legislation also prevents a 'swap dealer' or a 'major swap participant' that is an insured depository institution from using the inter-affiliate exemption provided under this legislation to address concerns raised last year.

Question 5. The Coalition for Derivatives End-Users has been on record for supporting strong regulations that "bring transparency to the derivatives market." How does the Inter-Affiliate Swap Clarification support that goal?

Answer. The Coalition for Derivatives End-Users seeks to ensure that financial regulatory reform measures promote economic stability and transparency without imposing undue burdens on derivatives end-users. Under the Inter-Affiliate Swap Clarification Act, certain trades would still be reported to regulators to meet the goal of transparency in the financial markets, but end-users would not be overly burdened in terms of clearing each internal transaction, which could be extremely costly.

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