

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING

Washington, D.C.

Tuesday, November 5, 2013

1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 SCOTT D. O'MALIA, Commissioner

6 MARK WETJEN, Commissioner

7 Staff:

8 JONATHAN MARCUS, Office of General Counsel

9 LEE ANN DUFFY, Office of General Counsel

10 STEVE SHERROD, Division of Market Oversight

11 RIVA SPEAR ADRIANCE, Division of Market
Oversight

12 DAVID PEPPER, Division of Market Oversight

13 HANNAH ROPP, Office of Chief Economist

14 VINCENT MCGONAGLE, Division of Market
Oversight

16 MARK FAJFAR, Office of General Counsel

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1 P R O C E E D I N G S

2 (9:40 a.m.)

3 CHAIRMAN GENSLER: Good morning. This
4 meeting will come to order. This is a public
5 meeting of the Commodity Futures Trading
6 Commission to consider proposed rules under the
7 Dodd-Frank Act.

8 I'd like to welcome members of the
9 public, market participants, and members of the
10 media, as well as those listening on the phone
11 lines and watching the webcast. I would like to
12 thank my fellow commissioners, Commissioners
13 Chilton, O'Malia, and Wetjen for their significant
14 contributions to the rule writing process and
15 thank this incredibly dedicated and hardworking
16 staff. And I extend that thanks in the midst of
17 some very unusual time for the CFTC that we not
18 only went through a 16-day government shutdown,
19 and I thank so many of you that were either
20 furloughed or back at work here, but then we're at
21 an unusual time that we have, unfortunately,
22 instituted administrative furloughs given our

1 budget circumstances. So, my deep appreciation
2 for your dedication and efforts.

3 Today we will consider two proposed
4 rules on position limits. I support seeking
5 public comment on each of these proposed rules.

6 Now, the CFTC does not set or regulate
7 prices. The Commission is charged with promoting
8 the integrity of the futures and swaps markets.
9 The Commission is charged with protecting both the
10 public from fraud, manipulation, and other abuses,
11 and since the Commodity Exchange Act passed in
12 1936, position limits have been a tool to curb or
13 prevent excessive speculation that may burden
14 interstate commerce. Those are the words of the
15 statute from 1936, and for a fuller understanding
16 of the long history of this Commission and our
17 predecessors on these matters, I'd actually like
18 to include in the record and in the proposed rule
19 preamble, a reference to the excellent testimony
20 of former General Counsel Dan Berkovitz from July
21 of 2009, which was the first of nine meetings of
22 this Commission on these matters.

1 That testimony is called "Position
2 Limits and the Hedge Exemption: Brief Legislative
3 History". Dan's concept of brief, it was 13
4 pages.

5 In the Dodd-Frank Act, Congress directed
6 the Commission to impose limits on speculative
7 positions and physical commodity futures and
8 options contracts and economically equivalent
9 swaps, and in 2011, the CFTC finalized a rule that
10 addressed Congress' direction to prevent any
11 single trader from obtaining too large a share of
12 the market to ensure that the derivatives markets,
13 futures and swaps, remained fair and competitive.

14 Last fall, a Federal district court
15 vacated that rule. It is critically important,
16 however, that those position limits or these
17 position limits be established, as I believe
18 Congress required.

19 The agency has historically interpreted
20 our obligations to promote market integrity to
21 include ensuring that markets do not become too
22 concentrated.

1 When the CFTC set position limits in the
2 past, and we've done so for nearly 70+ years --
3 again, I direct you to Dan Berkovitz's long
4 history of this -- it sought to ensure that the
5 markets were made up of a broad group of
6 participants with no one speculator having an
7 outsized position. Now, why is this? This
8 promotes the integrity of the price discovery
9 function in the market. How so? By limiting the
10 size of any one speculator's footprint in that
11 market.

12 Secondly, I believe the position limits
13 further protect the markets and the clearinghouses
14 possible burdens when any individual participant
15 may need to sell or liquidate a position in times
16 of individual stress, and we are a Commission and
17 an agency that part of our remit is to think about
18 when individual institutions need to liquidate
19 their positions in times of stress or default and
20 we also oversee clearinghouses in addition to
21 overseeing the price discovery function.

22 I think position limits have been part

1 of this regime because they help protect burdens
2 that can come from oversized positions for both the
3 price discovery function as well as the
4 clearinghouses.

5 Thus, I believe position limits help to
6 protect the markets both in times of clear skies
7 -- the price discovery function, certainly -- as
8 well as when there's a storm on the horizon --
9 both clearinghouses and price discovery function,
10 I think, are helped in those times through these
11 means and methods that were laid out seven to
12 eight decades ago by Congress.

13 With a strong proposal ready for
14 Commission consideration today, we determine that
15 the best path forward to expedite position limits'
16 implementation was to pursue a new rule and
17 dismiss the appeal of the district court's ruling
18 subject to the Commission's approval of this
19 proposal today.

20 This, I think, was a balanced decision
21 and like any decision, it was a matter of
22 judgment, but I do believe that this is the best

1 way to expedite position limit implementation.

2 Today's proposed rule is consistent with
3 Congressional intent. The rule establishes
4 Federal position limits in 28 referenced
5 commodities in agriculture, energy, and metals
6 markets as part of a phased approach allowing the
7 Commission time to look at other commodities
8 moving forward. It would establish one position
9 limits regime for the spot month and another for
10 single month and all months combined limits, as no
11 doubt the staff will walk us through.

12 Spot month limits would be set for
13 futures contracts that are being physically
14 settled as well as those swaps and futures that
15 can only be cash settled, and we're seeking
16 significant comment on alternatives, on the
17 approach from cash settled contracts, and no doubt
18 we'll get a lot of comments on that one particular
19 and important matter.

20 Spot month limits are very critical,
21 particularly as it relates to corners and squeezes
22 and other manipulative acts in the marketplace,

1 but also to ensure the price discovery function
2 and the protection of clearinghouses. But there's
3 another type of limit as well called single month
4 and all month combined limits, which the
5 Commission currently sets only for certain
6 agricultural contracts and we would, through these
7 roles, be reestablishing these types of limits in
8 the energy and metals markets.

9 You see, we had all months and single
10 month combined limits in the energy and metals
11 markets for a number of decades, and I think they
12 were removed -- Mr. Sherrod will remind me in the
13 history -- around 2001 in the energy markets, but
14 I can't remember in the metals markets.

15 These limits would be set using a
16 formula that is consistent with the practice the
17 CFTC has used for setting position limits for
18 decades, but again, we seek public comment on
19 that.

20 Consistent with Congressional direction,
21 the rule would also allow for bona fide hedge
22 exemption for agricultural and exempt commodities

1 -- metals and energies. Also following
2 Congressional direction, there is a narrower
3 exemption for swap dealers. You see, there were
4 some exemptions through no-action letters that
5 started about 22 years ago where swap dealers were
6 using a risk management exemption to do that which
7 many agricultural interests -- farmers and
8 ranchers and the like -- had done for decades to
9 sort of be exempt from position limits, not so
10 much because they had positions in their inventory
11 or they were growing the corn or wheat or
12 merchandizing, but that they came to this
13 Commission and used a risk management exemption.

14 Congress had a lot of debate on this. I
15 believe the statute is quite clear that we were to
16 narrow such exemption and this proposal today
17 narrows such exemptions with regard to swap
18 dealers while still allowing them to facilitate
19 the bona fide hedging of their customers through
20 what I've come to call the pass through provision.

21 Today's proposed position limits rule
22 builds on over four years of significant public

1 input. In fact, as I said earlier, this is the
2 ninth public meeting during my tenure as Chairman
3 to consider position limits. There is no other
4 matter that this Commission has met on more times
5 in the public than on position limits.

6 In fact, it's probably gotten more in
7 private meetings as well. We've held three public
8 meetings on the issue in the summer of 2009, got a
9 great deal of input from the markets at that point
10 in time. We benefitted subsequently to 8,200
11 comments we received on the January 2010 proposed
12 rulemaking to reestablish position limits in the
13 energy markets.

14 We further benefitted in March of 2010
15 from meetings publicly held about the metals
16 markets and then Dodd-Frank was passed and given
17 that new law, given Congress' mandate, we
18 actually, as it's called, pulled that initial
19 proposal and then we put out a new proposal in
20 January 2011 that I think was done through two
21 public meetings in December of 2010 and January of
22 '11. And then we got 15,100 comments there.

1 To say the public is interested in these
2 matters would be, I think, an accurate statement.

3 Before we hear from staff on the
4 rulemaking that we consider today, I'll recognize
5 my fellow Commissioners for their opening
6 statements. Commission Chilton?

7 COMMISSIONER CHILTON: Thanks. For a
8 couple of reasons, this is a pretty significant
9 day for me. I'm reminded of this great -- some of
10 you may recall the old Etta James song, "At Last".
11 So, there's two reasons it's significant for me,
12 one is that at last we've got this rule here.
13 This has been the signal rule for my entire time.
14 I came in 2007. This issue started in 2008. And
15 the second reason it's fairly noteworthy for me is
16 that this is going to be my last Dodd-Frank
17 meeting. I wrote to the President early this
18 morning and said I'll be leaving in the not too
19 distant future. And I waited until today, until
20 this meeting, for this rule proposal so we could
21 kick it out and even though the policy process
22 won't be completely done after this, it's nearing

1 an end and so today, at last, I'm pleased to say
2 I'll be saying vaya con dios, my comrades, and I'm
3 really exciting about what I'll be doing in the
4 future and enthusiastic.

5 With that, I do want to give a little
6 bit of history that dovetails a little bit with
7 what the Chairman said but is a little different.
8 None of my colleagues were here back in 2008 when
9 we started this, some of the staff were, but it
10 was a peculiar time. We saw Bear go down and then
11 we saw all this money coming -- the money I call
12 massive passive money -- saw all this money coming
13 into markets and prices going up, like in crude,
14 without much change in supply and demand.

15 And I went to some of the people -- some
16 that aren't here, by the way, now, so I'm not
17 talking about anybody certainly at this table --
18 and I said, what is the impact that this
19 speculation is having? And I was told, there is
20 no impact.

21 That was wrong. There's been lots of
22 studies. People can argue with the studies, but

1 there's lots of studies out there that show that
2 there is an impact.

3 So, I urged the Commission to use our
4 existing authority to implement limits, but I was
5 the only one that thought that was a good idea.
6 And then I worked with the Hill. There was a
7 bill, Commissioner Wetjen's former boss offered a
8 bill on speculation, Leader Reid. It was defeated
9 on a cloture vote. Commissioner O'Malia's boss
10 was there and talked about this issue, defeated on
11 cloture. And then later, in the fall, and our
12 legislative affairs director, John Riley will
13 remember this because he was working for Chairman
14 Peterson at the time, the House actually passed a
15 bill, under speculation -- on speculation, and
16 then they had enough votes under suspension and
17 then the votes were turned around and there
18 weren't enough votes and then you brought it up
19 two months later at the close of the session and
20 you actually passed a speculative position limits
21 rule. And thank you, John, for your work on that.

22 So, then we had Dodd-Frank pick up where

1 the Chairman started. We had all these meetings.
2 You know, I supported trying to do this under the
3 timeframe that Congress mandated, which was
4 January of 2011. That wasn't possible for a
5 variety of reasons, but that's what I thought we
6 should do. I won't reiterate what the Chairman
7 said about the process, but here we are, finally,
8 at last, today and we're going to take it to the
9 limits one more time.

10 Last thing I wanted to say is I wanted
11 to thank everybody at the table here and all the
12 other staff who've worked on this because it has
13 been a jaunty journey of ours on this rule and I'm
14 really proud of what we've come up with here
15 today. I think that it can't be -- this rule, if
16 we pass it, cannot be successfully challenged in
17 court. I think it will be good for markets, it
18 will be good for consumers.

19 And then I do want to thank my staff and
20 somebody that may be here but isn't with the
21 agency anymore, Salman Banaei, who led the
22 position limits team back in the day when we did

1 it the first time. He's gone off to greener
2 pastures, but we thank Salman for his expertise
3 and tireless work.

4 I also thank Nancy Doyle and then most
5 of all I want to thank Elizabeth Ritter.
6 Professor Elizabeth Ritter, emeritus, of
7 Georgetown, who actually started with me. She
8 helped me through the confirmation process, and
9 during that time when I was being told by staff,
10 nothing to see here, speculators don't impact, she
11 kept saying, "Keep asking, keep asking," and I
12 did.

13 There is not -- and I've said this many
14 times -- I don't believe there is a more talented,
15 ethical, thought-worthy derivatives lawyer in the
16 world and the Commission is phenomenally lucky to
17 have her and I am uber-phenomenally lucky to have
18 her working with me for the past several years.
19 So, thank you, Elizabeth, for that.

20 All right, at last we can move on.
21 Thank you very much.

22 CHAIRMAN GENSLER: Commissioner Chilton,

1 I hope I can do this before I turn to you,
2 Commissioner O'Malia, it has been a remarkable
3 journey. You are a true public servant and at
4 every step of the way these last four plus years
5 of service together, I think you've had the
6 interest of the public and the markets and the
7 investors and, yes, all the farmers and ranchers
8 and producers and merchants that we protect these
9 markets for, whether it's on customer protection,
10 position limits, all the swaps market reforms, the
11 futures markets enhancements, enforcement matters
12 that you've held this agency to a high standard,
13 and so I thank you.

14 I just still want to try to go at you a
15 little bit longer about whether this is your last
16 meeting, but we'll continue those conversations in
17 private.

18 Commissioner O'Malia?

19 COMMISSIONER O'MALIA: Well, this is
20 quite a day. I'm throwing out my speech and I'd
21 like to honor Commissioner Chilton for all his
22 work. The first time we met was, I think, at our

1 confirmation hearing on our -- the time we didn't
2 get through. I showed up, shaking like a leaf,
3 very prepared remarks, stayed on script. Bart
4 shows up with a highlighter and I think a back of
5 a pizza box on which he wrote his remarks, and he
6 just laid it down, and I was sitting there saying,
7 I'm going to -- I'm dead. I'm not going to make
8 it.

9 Well, the truth is, we didn't make it
10 that round but we did make it the next round.
11 I've really enjoyed working with probably one of
12 the smoothest, confident, capable Commissioners
13 we've had here, somebody I agree with in many
14 regards and someone who I respectfully disagree
15 with in other regards.

16 So, I am proud to have served with you
17 and worked with you on many of these issues, and I
18 look forward to seeing what you do in the future.
19 I'm sure we'll have opportunities to work
20 together, and I very much look forward to that,
21 and I look forward to completing this rule as
22 well. Similar rule, different legal strategy,

1 we'll see about -- if we've done our homework on
2 this one, but in doing our homework, I think
3 there's something that we can all rely on and all
4 agree on and I want to work very hard on this, and
5 that's the data.

6 We don't have the excuse of saying we
7 don't know what these markets are. We're
8 receiving data daily from everybody in the
9 markets, and we can rely on that data or we should
10 be able to rely on it, and I know we can't do it
11 today. There are a couple of footnotes that are
12 troubling in this rule that I think we need to
13 focus on, and that's making sure we do set rules
14 with reliable data that support them. I may be
15 outvoted on this one. I get it.

16 But at the same time, I want to make
17 sure that the rules we put in place are going to
18 be effective, useful, and achieve the goals we
19 anticipate, whatever they are. We may disagree on
20 what we anticipate out of these rules, but we
21 cannot make it up anymore. We don't have the
22 luxury of making it up, and we don't have the

1 excuse of being able to make it up because we
2 don't have the data.

3 We do have the data. We need to get the
4 data right and we need to put it to work.

5 So, that's all I'm going to say. I have
6 something I'll submit for the record, but this is
7 about my believe about Commissioner Chilton and
8 his service, not only here at the Commission, but
9 in the Senate, in the Agriculture Department as
10 well, a long role of public service and you should
11 be extremely proud of that, and I'm proud to work
12 with you. So, thank you.

13 CHAIRMAN GENSLER: Thank you,
14 Commissioner O'Malia. I think there's going to be
15 a lot of bipartisanship -- maybe not on the --

16 COMMISSIONER O'MALIA: Not on the vote.

17 CHAIRMAN GENSLER: Maybe not on the
18 vote, but it's always bipartisanship even when we
19 don't get your vote, by the way.

20 Commissioner Wetjen?

21 COMMISSIONER WETJEN: Yeah, once again
22 following Commissioner O'Malia I have to -- I find

1 myself wanting to echo a lot of the things that he
2 has said and I'm feeling compelled to do that here
3 again today. I'm not sure it makes any sense to
4 read the prepared statement at this point, so
5 maybe I'll just keep that for the record. That
6 will appear on the website and people can take a
7 look at it.

8 But I'm surprised by the news and
9 disappointed to know that you're going to be
10 leaving at some point soon, it sounds like, and I
11 guess the one thing I wanted to commend you for,
12 Commissioner Chilton, is you always have kept your
13 eye on the ball, and you've always had the small
14 investor, the consumer, the proverbial little guy
15 in mind, it seems to be, in your crosshairs all
16 the time, helping you pursue what it is you pursue
17 and the issues that you focus on, it seems to be
18 all with the interest of those folks in mind.
19 That's the one thing that has made a real
20 impression on me since I've served on the
21 Commission now for only two years.

22 And it's been a pleasure working with

1 you, it's been a pleasure being reminded of that,
2 that in so many ways that's really what this is
3 about. It's about markets, it's about efficient
4 markets, ones that permit price discovery and all
5 these other fancy things we say, but at the end of
6 the day it's also about people and those markets,
7 people in them or people affected by them in some
8 way, and there's just no doubt in my mind that is
9 always what's driving you.

10 I don't always agree with the way you go
11 about it or even the policy objectives, but I
12 never have had any doubts that the motives were
13 pure, and it's been a real interesting learning
14 experience for me watching you do that and
15 undertake your duties as a Commissioner in the way
16 you have.

17 So, I really appreciate that, I respect
18 that a lot, and wish you all the best.

19 COMMISSIONER CHILTON: Thank you.
20 Appreciate it.

21 CHAIRMAN GENSLER: You know, I don't
22 know if the staff really is going to do as well,

1 but I think before we turn to the staff, I did
2 want to note for the public that we had noticed
3 one other proposed rulemaking related to
4 membership in a registered futures association,
5 and I can't remember if it was yesterday or two
6 days ago now, it might have been Friday, that we
7 all signed that unanimously in seriatim and so
8 that's moving along to the Federal Register, and I
9 just want to note that, that that's occurred.

10 And just as I normally do, I seek
11 unanimous consent just for the staff to be able to
12 make any technical edits to these two documents
13 before they go to the Federal Register. Without
14 objection? And, again, Bart, this just is not
15 going to be the same without you. It's just not
16 going to be for the public who got the benefit of
17 your authorship of "Ponzimonium". It's not going
18 to be the same for the public that has seen you
19 just tirelessly on the speaking circuit and on
20 television looking out for those investors and
21 market participants. It's not going to be the
22 same for anybody in the staff who you look out for

1 every day, fighting for budget resources or just
2 fighting for sort of the right thing, and it
3 certainly is not going to be any -- it's not going
4 to be as much fun, by the way, for the
5 Commissioners.

6 So, in any event, Steve Sherrod. I want
7 to thank Steve Sherrod. You've been at the table
8 every time, all nine meetings, I think, but if you
9 tell me it wasn't, I do apologize. But Steve
10 Sherrod who's been the team lead on this all
11 along. Also from the Division of Market
12 Oversight, our new director, Vince McGonagle, Riva
13 Spear Adriance, oh, and David Pepper is from the
14 Division of Market Oversight. From the Office of
15 Chief Economist, but soon the Division of Market
16 Oversight, Hannah Ropp has worked on this for a
17 number of years and now is getting moved over to
18 the Division of Market Oversight.

19 Jonathan Marcus, our General Counsel,
20 Lee Ann Duffy, there's probably 10 or 15 other
21 people sitting in here that may come to the table
22 at one point or another if called. Steve?

1 MR. SHERROD: Well, good morning. Staff
2 is presenting for the Commission's approval
3 proposed amendments to position limit regulations.

4 As you mentioned, the staff at the table
5 worked on it along with a whole lot of other
6 staff, including Don Heitman, who's now retired,
7 so a lot of staff have worked on this.

8 Staff presenting today will be Jonathan
9 Marcus to discuss the legal mandate, Lee Ann Duffy
10 to discuss in an abundance of caution a necessity
11 finding, and then I will provide a summary of the
12 proposed regulations. Jonathan?

13 MR. MARCUS: Thank you, Steve. The
14 draft proposal contains a legal analysis, which
15 concludes that the Dodd-Frank Amendments to
16 section 4a require position limits on futures
17 options and swaps for physical commodities.

18 In the 2011 position limits rule, the
19 Commission determined that Section 4a, on its
20 face, clearly sets forth that mandate. Industry
21 groups challenged that interpretation in ISDA and
22 SIFMA versus CFTC. Those groups asserted that

1 contrary to the CFTC's interpretation, Section 4a
2 contains a clear requirement that the Commission
3 make contract-by- contract necessity findings
4 before imposing a limit in a specific market.

5 The district court rejected both
6 interpretations. Instead, the court held that
7 Section 4a is ambiguous on this point. It vacated
8 the rule and remanded it to the Commission to
9 resolve the perceived ambiguity. This proposal
10 resolves the ambiguity that the district court
11 identified.

12 The proposal starts with a key provision
13 that the court found ambiguous, Dodd-Frank Section
14 4a(a)(2). This provision says that the Commission
15 "shall" establish limits on agricultural and
16 exempt commodities "[i]n accordance with the
17 standards set forth in" Section 4a(a)(1).

18 It was this reference to "standards"
19 that the court found to be ambiguous. According
20 to the court, "standards" could refer to the
21 language in Section 4a(a)(1) authorizing the
22 Commission to impose position limits if it finds

1 them necessary to prevent the burdens of excessive
2 speculation. Or it could refer only to the
3 criteria in Section 4a(a)(1) for the
4 characteristics of the limits the Commission sets,
5 for example, how positions are to be aggregated to
6 avoid circumvention of the limits and how the
7 levels of the limits can be flexibly set depending
8 on the contract, delivery month, and so on.

9 The proposal resolves the perceived
10 ambiguity based on a number of factors and
11 concludes that the term "standards" is most
12 reasonably interpreted to refer to the criteria
13 for setting particular limits. Those factors
14 include the Commission's own experience with
15 position limits, the language and structure of
16 Section 4a as a whole, and its legislative
17 history, in particular the events that led to the
18 amendments made in Dodd-Frank.

19 First, the Commission's experience: For
20 45 years after the passage of the CEA in 1936, the
21 Commission's predecessor agency made findings of
22 necessity in its rulemakings establishing position

1 limits for particular commodities. This seriatim
2 approach to position limits generally followed
3 Congress' conferral of jurisdiction to the agency
4 over particular, enumerated commodities.

5 In those early rulemakings from the
6 1930s to the 1950s, it took many months for the
7 agency to conduct hearings and make a finding of
8 necessity with respect to just one commodity.
9 Dodd-Frank requires the Commission to have
10 completed the process of establishing position
11 limits for entire broad categories of commodities:
12 Within 180 days for exempt commodities and 270
13 days for agricultural commodities.

14 Within that short timeframe, the
15 Commission would be able to consider and make
16 case-by-case necessity findings for, at most, a
17 handful of commodities.

18 In staff's view, to infer such a
19 case-by-case necessity finding against that
20 backdrop of Commission experience would be
21 inconsistent with the 180- to 270-day time limits
22 prescribed in Dodd-Frank. For this reason, it is

1 unlikely that Congress could have intended the
2 Commission to do so within that timeframe.

3 Additional Commission experience informs
4 its determination that the "standards" referred to
5 in Section 4a(a)(2) do not include an antecedent
6 necessity determination. In 1981, in significant
7 part in response to the speculative conduct of the
8 Hunt brothers in the silver markets, the
9 Commission adopted its first major prophylactic
10 position limits rule following the establishment
11 of the CFTC seven years before.

12 Significantly, when the CFTC was
13 established, Congress greatly expanded the CFTC's
14 jurisdiction and authority to combat excessive
15 speculation by enacting a catch-all definition of
16 commodity including "all other goods and articles"
17 and "all services, rights, and interests".

18 Consistent with that much broader
19 authority, the 1981 rule, then CFTC Rule 1.61,
20 required exchanges to set position limits for all
21 futures contracts for which there were not already
22 limits. In the accompanying rule release, the

1 Commission explained that speculative position
2 limits are a beneficial tool in any market to
3 prevent manipulation of prices and to prevent
4 large or abrupt price movements attributable to
5 extraordinarily large speculative positions, even
6 in the absence of manipulative intent.

7 Like the Dodd-Frank Act, the 1981 rule
8 release stated that such limits "shall" be
9 established according to what the Commission
10 termed the "standards for establishing limits".
11 As used in the 1981 rule, "standards" meant the
12 criteria for determining how the globally required
13 limits would be set, including an aggregation
14 standard to prevent circumvention and a
15 flexibility standard to permit different levels
16 for different contracts or different months and
17 certain exemptions. "Standards" did not include
18 the antecedent judgment of whether to have limits
19 in the first place. That is because the
20 Commission had already made that antecedent
21 judgment. It said that "speculative limits are
22 appropriate for all contract markets irrespective

1 of the characteristics of the underlying market".

2 Based on that judgment, the Commission
3 directed the exchanges to set limits within 90
4 days in accordance with the standards set out in
5 Rule 1.61, which included the aggregation and
6 flexibility standards of Section 4a(a)(1), but did
7 not include any determination of necessity.

8 Dodd-Frank uses the same term,
9 "standards", and in substantial respects hews
10 closely to the Commission's 1981 rule. Like the
11 1981 rule, Section 4a(a)(2) says that the
12 Commission this time "shall" impose limits
13 according to the "standards" in Section 4a(a)(1).

14 Given the regulatory history described
15 above, an important component of the Commission's
16 expertise, it is most reasonable to interpret
17 standards consistently with the 1981 rule to mean
18 the characteristics of the limits that must be
19 set. After all, the 1981 rulemaking is the last
20 time the Commission definitively addressed and
21 identified the standards in Section 4a(a)(1) for
22 imposing across-the-board, prophylactic position

1 limits.

2 Also underscoring this relationship
3 between the 1981 rule and Dodd-Frank, both laws
4 established tight deadlines for establishing the
5 limits and a good faith exception for positions
6 acquired prior to the effective day of the
7 required limits. This good faith language entered
8 the Dodd-Frank process in a bill numbered H.R.977,
9 which Dodd-Frank ultimately incorporated virtually
10 verbatim.

11 The committee report accompany H.R.977
12 described the legislation as "Mandating the CFTC
13 to set speculative position limits."

14 The section-by-section analysis stated
15 that the legislation "requires the CFTC to set
16 appropriate position limits for all physical
17 commodities other than excluded commodities."
18 Again, this reflects the same omnibus,
19 prophylactic approach the Commission took in 1981.

20 Given that historical context, the most
21 reasonable interpretation is that Congress in 2010
22 intended the same prophylactic approach to

1 establishing mandatory limits for physical
2 commodity derivatives.

3 The legislative history leading up to
4 the Dodd-Frank amendments to the position limit
5 statute further supports the conclusion that
6 Congress intended the Commission to apply the same
7 standards the Commission required the exchanges to
8 apply in 1981.

9 In the years preceding enactment,
10 Congress conducted several in-depth investigations
11 and produced voluminous reports which concluded
12 that excessive speculation accounted for
13 significant volatility and price increases across
14 energy and agricultural physical commodity
15 markets. This excessive speculation occurred
16 during a time when, consistent with the Commodity
17 Futures Modernization Act, position limits on
18 certain futures contracts had been replaced by
19 position accountability, and limits on swap
20 contracts were the exception.

21 In 2008, Congress gave the Commission
22 authority to impose position limits on swaps that

1 serve a significant price discovery function.
2 After further investigations and findings
3 respecting excessive speculation, Congress, in the
4 Dodd-Frank amendments to the position limits
5 statute, acted against the backdrop of those
6 investigations and in light of those findings when
7 it directed the CFTC to establish the "required"
8 limits.

9 It is highly unlikely that Congress
10 intended the CFTC to duplicate those
11 investigations to assess whether to impose limits
12 on excessive speculation. Instead, it is more
13 reasonable to conclude that Congress reached that
14 judgment on its own and directed the Commission to
15 impose limits on derivatives for physical
16 commodities.

17 This interpretation is further supported
18 by the evolution of the position limits provisions
19 during Congress' consideration of Dodd-Frank. The
20 provisions were progressively strengthened as the
21 bill evolved. The legislation first introduced in
22 the House provided the Commission with

1 discretionary authority to issue certain position
2 limits. It stated that the Commission "may"
3 impose them. But, by the time it passed the
4 House, that language reflecting a permissive
5 approach was discarded in favor of mandatory
6 language, with the bill stating repeatedly that
7 the Commission "shall" impose limits.

8 Also reflecting the evolution from
9 discretionary to mandatory, the House along the
10 way added two new subsections, the tight time
11 deadlines described above, within which the
12 Commission was required to act, and a study
13 provision, which requires the Commission to study
14 the position limits it imposes and produce a
15 report to Congress within one year on their
16 effects.

17 It also requires the House Committee on
18 Agriculture to conduct a hearing on the report
19 within 30 days of receipt. We find it telling
20 that the deadlines and study provisions, along
21 with the first reference in the bill to the limits
22 being "required", all were added at the same time

1 the permissive "may" formulation was changed to
2 the mandatory "shall".

3 Later, the Conference Committee adopted
4 these provisions of the House bill and added three
5 more references to the position limits as
6 "required".

7 This interpretation also has the virtue
8 of giving meaningful content to what Congress did
9 in 2010 by adding six subsections to Section 4a.
10 Most relevant here, certain of those subsections
11 -- 4a(a)(2) and 4a(a)(5) -- direct the Commission
12 to set limits on physical commodity futures and
13 options and economically equivalent swaps within
14 tight deadlines.

15 When interpreting what those new
16 subsections mean, it is important to remember that
17 Section 4a(a)(1) already authorizes the Commission
18 to establish limits as it finds necessary on
19 futures, options, and swaps. In light of that
20 broad authorization, the new subsections must go
21 further.

22 It has been argued that the mandate in

1 Section 4a(a)(2) only "mandates" that the
2 Commission impose limits when it finds them
3 necessary, but that makes little sense because the
4 agency, in all cases, would impose limits it found
5 "necessary" without extra direction from Congress.
6 There is no history of the agency finding a limit
7 "necessary" and then declining to impose one, and
8 there is no reference in the legislative history
9 to that sort of phenomenon.

10 Arguments have also been made that the
11 phrase "as appropriate", which appears in the
12 provisions the proposal construes as a mandate,
13 requires the Commission to first determine that
14 having a position limit is appropriate.

15 The court found this language to create
16 ambiguity as to whether limits were in fact
17 required or whether the "as appropriate" phrase
18 was a delegation to the Commission to set limits
19 at appropriate levels.

20 The proposal addresses the ambiguity and
21 concludes that "as appropriate" refers to
22 discretion on limit levels, not on whether or not

1 to have position limits. If the Commission must
2 first determine whether imposing a position limit
3 is "appropriate", then the Commission's
4 responsibility is not meaningfully different than
5 it would be without the subsections added by
6 Dodd-Frank.

7 Thus, to give any real, practical effect
8 to the sections added by Dodd-Frank, neither the
9 reference to "standards" nor to "as appropriate"
10 can incorporate an antecedent necessity finding.

11 On the other hand, the opposite is not
12 true, that is, the direction in Section 4a(a)(1)
13 to the Commission to impose limits when it finds
14 them "necessary" still has a meaningful role to
15 play under the proposed interpretation. That is
16 because the Dodd-Frank mandate applies only to
17 agricultural and exempt commodities, a subset of
18 the contracts within the scope of Section
19 4a(a)(1), which covers all derivatives. Thus, the
20 authorization in Section 4a(a)(1) to the
21 Commission to impose limits as it finds necessary
22 still applies to excluded commodities.

1 Further, as I have mentioned, Dodd-Frank
2 instructs the Commission to impose the "required"
3 limits quickly, within 180 days for exempt
4 commodities and 270 days for agricultural
5 commodities. In context, it is not the most
6 reasonable interpretation to conclude that the
7 limits were discretionary. If they were
8 discretionary, the deadlines would be a non
9 sequitur and Congress would not have repeatedly
10 referred to the limits as "required".

11 Finally, Dodd-Frank requires the
12 Commission to conduct a retrospective study, and
13 the language of that provision presupposes that
14 there will be limits to study. The instruction is
15 to study the "effects (if any) of the position
16 limits imposed." The proposal notes that
17 retrospective study requirements like this one go
18 hand-in-hand with mandated action, not
19 discretionary action.

20 In sum, the proposal before you complies
21 with the district court's remand order by bringing
22 the Commission's experience and expertise to bear

1 on resolving the ambiguity the district court
2 perceived in the statute. The proposal concludes,
3 based on all the sources discussed above, that
4 Congress decided that position limits were
5 necessary for physical commodities.

6 Based on that judgment, Congress
7 required the Commission to impose them
8 expeditiously in accordance with the standards in
9 Section 4a(a)(1) that the Commission had
10 previously identified for establishing
11 across-the-board, prophylactic limits.

12 I now turn to Lee Ann Duffy for a
13 summary of the necessity finding, which we
14 recommend out of an abundance of caution. Thank
15 you.

16 MS. DUFFY: As Jonathan explained, the
17 proposal concludes that the Commodity Exchange Act
18 mandates the imposition of speculative position
19 limits. Because of this mandate, the Commission
20 need not make a finding that speculative position
21 limits are necessary to diminish, eliminate, or
22 prevent excessive speculation causing sudden or

1 unreasonable fluctuations or unwarranted changes
2 in the prices of commodities.

3 Nonetheless, in the light of the
4 district court's decision, and without prejudice
5 to any argument the Commission may advance in any
6 forum, the proposal contains a preliminary finding
7 that such limits are necessary to achieve their
8 statutory purposes as a separate and independent
9 basis for the proposed rule.

10 Historically, speculative position
11 limits have been one of the tools used by the
12 Commission to prevent, among other things,
13 manipulation of prices. Limits do so by
14 restricting the size of positions held by
15 noncommercial entities that do not have hedging
16 needs in the underlying physical markets.

17 By capping the size of speculative
18 positions, limits lessen the likelihood that a
19 trader can obtain a large enough position to
20 potentially manipulate prices, engage in corners
21 or squeezes or other forms of price manipulation.

22 The position limits in this proposal are

1 necessary as a prophylactic measure to lessen the
2 likelihood that a trader will accumulate
3 excessively large speculative positions that can
4 result in corners, squeezes, or other forms of
5 manipulation that cause unwarranted or
6 unreasonable price fluctuations.

7 The preamble of the proposal states that
8 in the Commission's experience, position limits
9 are also necessary as a prophylactic measure
10 because excessively large speculative positions
11 may cause sudden or unreasonable price
12 fluctuations even if not accompanied by
13 manipulative conduct.

14 Two examples that inform the
15 Commission's determinations are the silver crisis
16 of 1979-80 involving the Hunt brothers and events
17 in the natural gas markets in 2006.

18 In Section 4a(a)(1) of the Act, Congress
19 identifies "sudden or unreasonable fluctuations or
20 unwarranted changes in the price of such
21 commodity" as an indication that excessive
22 speculation may be present in a market for a

1 commodity.

2 The rapid rise and sharp decline in the
3 price of silver that commenced in August 1979 and
4 was spent by the end of March 1980 certainly fits
5 the description advanced by Congress.

6 Nevertheless, the Commission in this proposal
7 expresses the belief that, based on its experience
8 and expertise, the burdens on interstate commerce
9 are not limited solely to the temporary and
10 unwarranted changes in price such as those
11 exhibited during the silver price spike that
12 resulted, at least in part, from the deliberate
13 behavior of the Hunt brothers and their cohorts.

14 Indirect burdens on interstate commerce
15 may arise as a result of unwarranted changes in
16 price such as occurred in the silver price spike
17 of 1979-80. Such burdens arise due to
18 manipulation or attempted manipulation, or they
19 may result from the excessive size and disorderly
20 trading of a speculative, that is, non-hedging,
21 position.

22 The Commission reiterates the belief

1 expressed in prior rulemakings that if federal
2 speculative position limits had been in effect
3 that correspond to the limits that the Commission
4 will propose now, across markets now subject to
5 Commission jurisdiction, such limits would have
6 prevented the Hunt brothers and their cohorts from
7 accumulating such large futures positions.

8 The proposal would also find that
9 speculative position limits would help to diminish
10 or prevent unreasonable fluctuations or
11 unwarranted changes in the price of a commodity,
12 such as the extreme price volatility in the 2006
13 natural gas markets.

14 The preamble describes how the findings
15 of the staff of the Permanent Subcommittee on
16 Investigations of the United States Senate about
17 the 2006 natural gas markets support the
18 imposition of speculative position limits outside
19 the spot month. Based on assumptions described in
20 the preamble, the proposal expresses the belief
21 that if Commission-set speculative position limits
22 had been in effect that correspond to the limits

1 that the Commission will propose, across markets
2 now subject to Commission jurisdiction, one market
3 participant would not have been able to build such
4 large futures positions in futures and swaps and
5 thereby would have restricted its ability to cause
6 harmful price effects that limits are intended to
7 prevent.

8 The proposal also states that position
9 limits would prevent the accumulation of
10 extraordinarily large positions that could
11 potentially cause unreasonable price fluctuations
12 even in the absence of manipulative conduct.

13 The text of Section 4a(a)(1) of the Act
14 itself establishes its broader purpose: It
15 authorizes limits to prevent price distortions
16 that can potentially occur due to excessive
17 speculation (that is, excessively large
18 speculative positions), without regard to whether
19 it is manipulative.

20 The Commission has long interpreted the
21 provision as authorizing limits to achieve this
22 broader purpose and it has long found that limits

1 are necessary to do so. The preamble recites
2 instances of such findings.

3 MR. SHERROD: Thanks, Lee Ann. In
4 addition to the staff at the table that the
5 Chairman recognized, I know we had a number of
6 economists who worked on drafting this proposal or
7 analysis that's included in the proposal and I'd
8 like to just mention them briefly.

9 From the Division of Market Oversight
10 includes Steve Benton, Lee-Ken Choo, Ken Danger,
11 Christa Lachenmayr, Lynn Riggs, and Martin Murray,
12 and from the Office of Chief Economist, in
13 addition to Hannah, we had Stephen Kane, Scott
14 Mixon, David Reiffen, and some others. Right?

15 And so today I will provide a summary of
16 the scope of the draft proposed Federal limits and
17 then a summary of the basic components of the
18 Federal limits and associated reporting rules, and
19 finally, a summary of the proposed requirements
20 and guidance for designated contract markets and
21 certain swap execution facilities.

22 The scope of the proposed regulations

1 cover 28 core physical commodity futures contracts
2 and their economic equivalent futures, options,
3 and swaps. Collectively these are called
4 referenced contracts.

5 Those 28 core physical commodity futures
6 contracts include nine futures contracts currently
7 subject to Federal position limits and 19
8 additional futures contracts.

9 To select the 28 contracts, physical
10 commodity derivative contracts were sorted based
11 on the largest notional value of open interest,
12 and open interest by the broad commodity groupings
13 of agriculture, energy, and metals. The top 16
14 agricultural commodities, 4 energy commodities,
15 and 5 medical commodities were selected, and once
16 these commodities were selected, the leading
17 futures contracts in a particular commodity,
18 generally futures contracts with the highest
19 levels of open interest, those were deemed the
20 core referenced futures contracts, so there are 19
21 in the agricultural commodities, 4 in energy, and
22 5 in metals.

1 Staff is recommending a phased approach
2 to complying with the Congressional mandate,
3 initially selecting these 28 core futures
4 contracts rather than all physical commodities.

5 In subsequent releases, the Commission
6 would propose to expand the list of core
7 referenced futures contracts to include all
8 physical commodities subject to the authority that
9 Congress provided under Section 4a(a)(7) of the
10 Act to exempt, among other things, a class or
11 contract of commodity derivative contracts.

12 A phased approach will reduce the
13 potential administrative burden by not immediately
14 imposing position limits on all commodity
15 derivative contracts and physical commodities at
16 once, and it may facilitate adoption of monitoring
17 policies, procedures, and systems by persons not
18 currently subject to limits, such as traders in
19 swaps that are not significant price discovery
20 contracts, which may not be subject to any limits
21 currently.

22 By way of example of the administrative

1 burden, Commission staff has identified 464
2 separate commodity derivative contracts that would
3 be referenced contracts under the proposal.

4 Now, turning to the basic components,
5 there are three basic components to the current
6 position limit regulations, one is the level of
7 the position limits, two, the exemptions, and
8 three, the aggregation standards. This proposal
9 would amend the first two components, and the
10 third component regarding aggregation of positions
11 is the subject of a separate staff recommendation.

12 Regarding the first component, the
13 proposal would establish levels of limits for each
14 spot month, each single month, and for all months
15 combined, consistent with current federal limits
16 and Commodity Exchange Act Section 4a(a)(3).

17 Spot month limit levels will be set
18 generally at no larger -- no greater than 25
19 percent of estimated available supply. The spot
20 month is not a calendar month, and rather, under
21 the proposal, and consistent with the current
22 exchange practices, it's a period of time,

1 generally the earlier of the last three days of
2 trading or the time period that begins when a
3 short position holder can give notice of intent to
4 deliver prior to the close of trading.

5 These spot month limits would be applied
6 separately to physical delivery reference
7 contracts and cash settled reference contracts in
8 the same commodity. The proposed initial spot
9 month levels would be based on the current levels
10 at exchanges listing the core referenced futures
11 contracts.

12 Alternatively, the proposal would permit
13 the Commission to establish higher initial spot
14 month levels based on estimates of deliverable
15 supply submitted by the CME group if those
16 estimates are verified by the Commission, or such
17 lower level that an exchange listing the core
18 referenced futures contract may recommend.
19 Subsequent levels would be adjusted no less
20 frequently than every two years.

21 These subsequent levels would be set at
22 no higher than 25 percent of the Commission's

1 estimate of deliverable supply developed in
2 consultation with the DCMs. Non-spot month
3 position limits, that is, limits applied to
4 positions in a single contract month or all months
5 combined, would be set using what we call the 10 -
6 2.5 percent formula, that is, 10 percent of the
7 first 25,000 contracts of average open interest
8 for a calendar year and 2.5 percent of the average
9 open interest over 25,000 contracts.

10 The initial levels of non-spot month
11 limits would be based on open interest in futures
12 and options traded on DCMs, as well as swaps that
13 are significant price discovery contracts.

14 Swaps and futures options would be
15 included in that open interest on a futures
16 equivalent basis. Subsequent levels would be
17 adjusted no less frequently than every two years
18 based on referenced contract open interest for a
19 calendar year.

20 Open interest used in determining
21 subsequent non-spot month position limits would be
22 the sum of futures open interest reported under

1 part 16 and swaps open interest, as reported
2 either to the Commission under part 20 or to a
3 swaps data repository. The second component,
4 exemptions from position limits, would provide
5 five categories of exemptions for, number one,
6 positions that are bona fide hedging positions,
7 two, financial distress positions, three,
8 conditional spot month limit positions, four,
9 other positions as the Commission may exempt under
10 Commodity Exchange Act Section 4a(a)(7), and five,
11 exemptions for positions that are established in
12 good faith prior to the effective date of initial
13 limits established by the regulations.

14 The Commission's associated reporting
15 rules in parts 17 and 19 would also be amended to
16 collect information related to the new exemptions.
17 The proposal would amend the existing definition of
18 bona fide hedging for positions in physical
19 commodities to conform to the requirements in the
20 Dodd-Frank Act.

21 Proposed new enumerated bona fide
22 hedging exemptions would include: Unfilled

1 anticipated requirements for resale by a utility,
2 royalties, and service contracts.

3 In addition to the amendments to the two
4 components of the Federal position limit
5 regulations and amendments to the associated
6 reporting rules, staff also recommends
7 requirements and acceptable practices for DCMs and
8 swap execution facilities that are trading
9 facilities for setting position limits for the 28
10 referenced contracts as well as position limits or
11 accountability rules in all other listed
12 contracts, including contracts in excluded
13 commodities.

14 In general, DCMs and SEFs would be
15 required to use the Commission's bona fide hedging
16 definition for physical commodity derivatives and
17 use the Commission's aggregation standards for all
18 position limits.

19 The amended definition of bona fide
20 hedging for excluded commodities would incorporate
21 provisions of two 1987 interpretative statements,
22 continuing to provide flexibilities for DCMs and

1 SEFs to grant risk management exemptions in
2 excluded commodities.

3 And that concludes my summary. The
4 staff would be happy to take any questions that
5 you may have.

6 CHAIRMAN GENSLER: Thank you, Steve. I
7 think I first will entertain a motion on position
8 limits. I think Commissioner Chilton might want
9 to make that motion.

10 COMMISSIONER CHILTON: I move the
11 proposed rule.

12 COMMISSIONER O'MALIA: Second.

13 CHAIRMAN GENSLER: Second from
14 Commissioner O'Malia. I thank you. I feel I've
15 asked a lot of questions in the eight prior
16 meetings that we've had this, but I do want to
17 focus on one thing, which is the really remarkable
18 work in here that staff has done. I presume,
19 Hannah, you've had a lot of involvement in this
20 and, of course, everybody from the Division of
21 Market Oversight on the review of 130 studies, and
22 there's a list in the appendices of these 130

1 studies, and then a review on page after page
2 after page summarizing these studies.

3 Before I turn to the question, I really
4 do encourage the public to dig into these studies,
5 to give this Commission advice, comments, counsel
6 with regard to these studies. They're at the
7 heart of cost-benefit analyses, but they're also
8 -- or cost-benefit considerations, to use the
9 technically precise term -- but they're also a bit
10 of the heart of this necessity finding, and so I
11 turn to page 56, for those of you who have the
12 document.

13 And I am glad that there's a statement
14 in here, after summarizing the studies, and of
15 these 130 studies, there are studies that are
16 suggestive that speculation in markets and
17 excessive speculation do have burdens on
18 interstate commerce and burdens that are in the
19 markets, and there are other studies that suggest
20 otherwise. It's a mixed reading of the studies.

21 There are studies that say position
22 limits have a positive effect and there are other

1 studies that say they can't find any such positive
2 effects.

3 I remember, I think, amongst the studies
4 two separate parts of the Federal Reserve system,
5 one study out of St. Louis Federal Reserve and one
6 study out of Chicago, I think come out on
7 different sides of this. Is that right, Hannah,
8 roughly speaking, or Steve? Do you want to --
9 just for the record?

10 MR. SHERROD: That's right.

11 CHAIRMAN GENSLER: Right. So, two
12 different parts of the Federal Reserve, I think,
13 even have different places in this study. But
14 there's an appendix that has the 130 studies and,
15 you know, over about a dozen pages in this rule.

16 But particularly I'm looking at that it
17 says, "In any case, these studies, over all, show
18 a lack of consensus regarding the impact of
19 speculation on commodity markets and the
20 effectiveness of position limits."

21 So, we have 130 studies, we have some
22 that say speculation affects the markets, some

1 that say maybe it doesn't, some that say position
2 limits work, some that maybe say it doesn't.
3 Could you just give a little summary of that and
4 then I'm going to speak to how I, as one
5 Commissioner, take this all in?

6 MS. ROPP: Absolutely. In these 130
7 studies that we and -- myself and my colleagues
8 have reviewed, about 50 of them were actually
9 submitted during the last round of position limit
10 rulemakings, so we do know that market
11 participants and the public are also reading
12 these. We decided to be even more expansive than
13 they were the last go around.

14 What we ended up finding was that while
15 some of these studies show -- some of them look at
16 speculation in particular, some of them show that
17 there may be a relationship between the amount of
18 speculation in a market and price movements or
19 price volatility. Other studies find no such
20 connection. Still more studies are inconclusive
21 as to whether or not there is such an impact.

22 Overall, very few of these studies have

1 any real input onto position limits in particular,
2 whether or not they should be implemented, how
3 they should be implemented, that sort of thing,
4 making them largely inconclusive when it comes to
5 their impact on our policy here today.

6 The lack of consensus is consistent
7 throughout all of them, strange as that sounds.
8 We've got about a third of them that say excessive
9 speculation has an impact, about a third that say
10 it doesn't, and about a third that says they can't
11 tell.

12 CHAIRMAN GENSLER: So, if I can pause
13 there, Jonathan, when I look at this I look at a
14 third that say it does have an effect, a third
15 that maybe says it doesn't, and a third that's, as
16 Hannah said, doesn't maybe address it. I'd call
17 that, to the American public, sort of a classic
18 jump ball, if I can use the expression. Is that
19 all right, Jonathan? I'm going to ask you a legal
20 question in a second, but do you understand what I
21 mean by that?

22 MR. MARCUS: Yes.

1 CHAIRMAN GENSLER: So, I think of this,
2 Congress -- in light of Congress' clear intent,
3 though a district court judge said, all right, go
4 back, and within your realm of rulemaking, make
5 some determinations, findings, necessity, and so
6 forth. I find that if a third of the studies say
7 this does have an effect and maybe a third says it
8 doesn't, that jump ball, that it's better to err
9 on the side of caution, that using my judgment as
10 a Commissioner, it's better because there are dire
11 consequences if the third of the studies that say
12 there is an effect were somehow ignored by this
13 Commission, particularly in light of Congress'
14 intent.

15 And so, I'd like to know from you, do I
16 sort of -- is that framing appropriate?

17 MR. MARCUS: Well, I would just first
18 say that, I mean, with respect to the district
19 court, the district court did not require us to do
20 necessity findings. The district court identified
21 an ambiguity in the statute as to whether we had a
22 mandate to impose limits without such findings,

1 and as you know, the proposal undertakes the
2 analysis that the district court asked us to do by
3 bringing our experience and expertise to bear, and
4 we, of course, have concluded, based on that
5 analysis, that Congress did in fact intend to
6 require us to impose -- require the Commission to
7 impose position limits without such studies and
8 findings.

9 And if that is the case, of course,
10 studies that talk about whether excessive
11 speculation exists or whether it's a problem would
12 not be pertinent to the mandate that we have to
13 follow from Congress. Of course we have to take
14 our instructions from Congress and following
15 Congress' instructions.

16 But if you assume that there is no such
17 mandate and the Commission does have to undertake
18 the traditional -- undertake its own discretionary
19 determination whether position limits are needed,
20 then -- I think then you get into the framework of
21 the necessity findings and the studies that have
22 looked at this. And I agree, I think -- but you

1 still get guidance from the fact that Congress in
2 4a(a)(1) has said that excessive speculation in
3 4a(a)(1), Congress itself has made a finding that
4 excessive speculation does cause unwarranted price
5 fluctuations, and Congress also indicated through
6 4a(a)(1) that position limits are an effective
7 tool. So, I think those have to weigh heavily on
8 the scale when you're interpreting studies that go
9 kind of in both directions. And so, I do agree
10 that in light of the fact that Congress gave the
11 Commission this prophylactic authority to protect
12 the markets from excessive speculation that
13 Congress believed does have harmful effects, that
14 does exist and can have harmful effects, it is
15 appropriate to look at all these studies and err
16 on the side of caution in implementing a
17 prophylactic regime.

18 CHAIRMAN GENSLER: I mean, for me, I
19 thank you for that answer, for me, I think the
20 position limits help promote the integrity of the
21 markets. No one speculative position, no one
22 party has an outsized influence that might

1 influence price discovery when times are good or
2 influence price discovery or even the risk of the
3 clearinghouse when times are bad and that position
4 needs to be unwound or liquidated. But I also
5 look to the studies and I see this demonstrable
6 lack of consensus, and I think as a prophylactic
7 matter, it's better to err on the side of caution
8 than to kind of ignore the at least one-third that
9 say there could be a real problem here, and I
10 think it would be not only inconsistent with
11 Congress, but in a sense, then, you know, ignoring
12 a vast body of work that suggests that there could
13 be problems here.

14 MR. MARCUS: I agree. I think that is
15 the right way to frame the concerns and how to
16 address them.

17 CHAIRMAN GENSLER: All right. So, I
18 don't know if it would be a technical edit or not,
19 but on this one paragraph I might have like five
20 or six words just to try to frame or something,
21 but I'm going to turn to Commissioner Chilton.
22 That's my only question.

1 COMMISSIONER CHILTON: Thanks again for
2 all your work. Jonathan and Lee Ann, you did a
3 great job on this, thank you.

4 I could go a lot of places but I'm just
5 going to stick right now on studies for a little
6 bit. Hannah, because I'm not 100 percent sure on
7 this, Chicago -- this Federal Reserve Bank of
8 Chicago -- I know there's a Federal Reserve Bank
9 -- and I don't want to get into the bidding
10 studies, as you'll see, but I want to make sure I
11 get something correct. The Federal Reserve Bank
12 of St. Louis, I know, links speculation and
13 prices. I'm not aware of a Federal Reserve Bank
14 of Chicago that said there was no link, are you?

15 MS. ROPP: I'm not recalling it at the
16 moment. Again, after 130 studies it might just
17 not be at the top of my head.

18 COMMISSIONER CHILTON: I guess the only
19 government report that I am -- only government
20 study -- government study I'm aware of is this
21 Federal Reserve Bank of St. Louis, which showed a
22 link between speculation and prices, okay, so to

1 prove it I'm not going to debate all these
2 studies, I'll just look for some quick -- Hannah,
3 I'm going to ask you "yes" and "no" answers if you
4 can.

5 Are you aware of any study that looks at
6 supply and demand and links in 2008, when
7 consumers were paying \$4.11 per gallon for gas,
8 the highest still today that they've ever paid and
9 crude oil reached \$147.27, summer 2008 -- are you
10 aware of any study that proves that supply and
11 demand caused those prices?

12 MS. ROPP: There are studies that
13 certainly argue that --

14 COMMISSIONER CHILTON: That supply and
15 demand caused it to go to \$150?

16 MS. ROPP: There are studies that think
17 that there are supply and demand factors that
18 caused that jump, there are studies that believe
19 that --

20 COMMISSIONER CHILTON: I'd like to see
21 those.

22 MS. ROPP: -- there are supply and

1 demand factors --

2 COMMISSIONER CHILTON: I'd like to see
3 those. I've been asking everybody in speeches
4 for, you know, three years. I'd like to see them.

5 MS. ROPP: I will say, I don't believe
6 it's been proven. Nobody has conclusively said
7 that that is the only way it could be --

8 COMMISSIONER CHILTON: Supply and demand
9 was going like this. Supply and demand was about
10 even. Crude oil went from \$90 to nearly \$150 and
11 then back down to the 30s, and supply and demand
12 was moving a little bit. Supply and demand was
13 fairly static. The prices were anything but, so
14 it's hard for me.

15 Okay, are you aware of any study that
16 links -- that detaches speculation from prices
17 that wasn't funded by the industry?

18 MS. ROPP: What do you mean "detaches"?

19 COMMISSIONER CHILTON: That says that
20 there's no relation between excessive speculation
21 and prices. Is there any study you're aware of
22 that wasn't funded by the industry, either through

1 a researcher that was funded through the industry
2 or by an industry group -- news flash, industry
3 groups says industry not to blame for prices. Is
4 there any study you're aware of that dismisses the
5 link to speculation to prices that isn't funded by
6 the industry?

7 MS. ROPP: I can't answer that question.
8 I'm not sure who is funding whom.

9 COMMISSIONER CHILTON: Okay. I've
10 looked at a lot of them. And then, lastly, part
11 of the problem in all of these studies, and this
12 happens all the time in government, is that the
13 question that people want to say is whether or not
14 speculators -- they want it to be black and white,
15 whether or not speculators drove prices, can you
16 pin it all on them, and that's not the question we
17 should be asking.

18 If consumers are paying 10 cents more a
19 gallon of gasoline because in part excessive
20 speculation has contributed to prices, that's a
21 concern for this agency. We're not just concerned
22 about did they cause all of it, we're the

1 consumer's advocate, that's what we're supposed to
2 do.

3 I'll defer anything for later, Mr.
4 Chairman. Thank you.

5 CHAIRMAN GENSLER: Commissioner O'Malia.
6 Thank you, Commissioner Chilton.

7 COMMISSIONER O'MALIA: Thank you. Mr.
8 Sherrod, footnote 426, I'll just read it, it's on
9 page -- well, on the version I have, I don't know
10 if it's the same version you have right now, says,
11 "Several reporting entities have submitted data
12 that contained stark errors. For example, certain
13 reporting entities submitted position sizes that
14 the Commission determined to be 1000 times or even
15 10,000 times too large.

16 Can you explain what the nature of our
17 data shortcomings are and what this footnote
18 relates to?

19 Well, I can -- it says -- the footnote
20 relates to a sentence and the document says, "The
21 Commission is considering using Part 20 data," our
22 large trader data, right, "should it determine

1 such data to be reliable in order to establish
2 higher initial levels in a final rule" and then it
3 says, "the data is wholly unreliable".

4 Can you explain the challenges we're
5 facing with the data and what we are using to base
6 these position limits on?

7 MR. SHERROD: Sure. As part of
8 Dodd-Frank, the Commission received authority over
9 swaps and promulgated a new rule, Part 20, to
10 require certain entities to report swaps positions
11 in physical commodities that were enumerated in
12 Part 20. It includes the 28 commodities that are
13 the subject of this proposal.

14 The first reporting entities are
15 essentially clearing members of derivative
16 clearing organizations. Those clearing members
17 were to take their physical commodity swaps,
18 convert them to futures equivalents under guidance
19 provided by Commission staff, and report them on a
20 daily basis. They gained experience with that
21 reporting process and the error rates with our
22 Office of Data and Technology working with the

1 reporting firms, they seem to be doing better, and
2 by January of 2013, we had what we thought to be a
3 reasonably improved -- it was certainly much
4 better than the early reporting under Part 20.

5 In a second phase, the reporting
6 entities were expanded to include swap dealers and
7 major swap participants and as those reporting
8 entities that were not clearing members of
9 derivative clearing organizations started
10 reporting, that's some of the errors that are
11 referred to in this footnote.

12 More recently, and not in the text of
13 this preamble, but I mean more recently in the
14 last few weeks, a major reporting firm has, again,
15 in some way changed their process, most likely,
16 and introduced stark errors into their process
17 reporting futures equivalents on the order of 2.5
18 billion contracts in a particular commodity. It's
19 just off by, you know, clearly an order of
20 magnitude of swaps that they have outstanding.

21 Now, it's dependent upon the reporting
22 entities to give us accurate data, it's their

1 obligation under Part 20, but it is a complex
2 undertaking and our staff at the Commission have
3 been working with those firms to try to improve
4 that data.

5 Our hope is that the data quality will
6 continue to improve and that we would be able, in
7 a final rule, to be able to rely upon that
8 information.

9 COMMISSIONER O'MALIA: So, what is the
10 data that we're using to inform us about the
11 precise limits and whether, now that we're
12 experts, as Mr. Marcus points out in our legal
13 strategy, what is our expert opinion and what is
14 the expert data we are applying to set these
15 limits?

16 MR. SHERROD: Right. By way of
17 background, to frame the reference for this
18 discussion, on page 182, in table 12, we provide
19 you a summary of the Part 20 data, the average
20 daily open interest for January of 2013, and in
21 general it shows that, for a number of these
22 commodities, there aren't a lot of open positions

1 in swaps that are being reported by these
2 reporting entities.

3 There are a significant amount reported,
4 the largest in swaps linked to NYMEX natural gas,
5 where there's about a million and 60,000 futures
6 equivalents reported. Those are reported in the
7 category of uncleared swaps. So what the staff is
8 recommending is that we use the data that we've
9 consistently been receiving since the Commission
10 received authority under the 2008 Farm Bill, and
11 those would be the data we have for futures and
12 options every day in the large trader reporting
13 system, and the data we receive on swaps, on
14 significant price discovery contracts under the
15 Part 36 authority that was passed after the Farm
16 Bill.

17 COMMISSIONER O'MALIA: Congress gave us
18 kind of a difficult challenge and setting these
19 specific limits, I think, is the category
20 reference. It says, you know, there are four
21 factors: Diminish excessive speculation, deter
22 manipulation, at the same time, ensure liquidity

1 for hedging, and price discovery. How are these
2 limits walking that narrow line to ensure that we
3 diminish the excessive speculative concerns and
4 obviously enhance hedging and price discovery?

5 MR. SHERROD: So, staff, over the
6 decades, has consistently recommended position
7 limits that are at the outer bounds, high levels.
8 Because of particularly concerns about not
9 interfering with the price discovery function of
10 the markets, speculators certainly are in the mix
11 of traders and contribute to that. Speculators
12 also may provide adequate liquidity for bona fide
13 hedgers in the marketplace and so staff again
14 recommends using the traditional formulas that set
15 limits at kind of the outer bounds on the high
16 side.

17 The other objectives, for example,
18 diminishing the potential for manipulation,
19 corners, or squeezes, or the harm in excessive
20 speculation causing, you know, the excessive price
21 volatility that could lead to those negative
22 externalities, those are things that staff have

1 weighed and in light of where we recommend the
2 limit levels, very large. So, for example, the
3 existing limit level that we're also recommending
4 to be retained for wheat on the Chicago Board of
5 Trade is 600 contracts. That's three million
6 bushels of wheat. That's 180 million pounds of
7 wheat. That's in the spot month.

8 In the current individual month, single
9 month limit, is 20 times that large. These are
10 enormous quantities. Just for the benefit of
11 those that kind of can't weigh the contents, it's
12 like the spot month limit is 4,000 semi trucks
13 full of wheat and the single month limit is 20
14 times that large. So, these are certainly erring
15 on the high side and we think there should be
16 adequate liquidity for the bona fide hedgers and
17 the price discovery process will continue. It
18 doesn't mean that the limits would prevent all
19 manipulation or all price distortions. The
20 continuing obligation will be on traders not to
21 manipulate the market. By staying under the
22 position limit, it's not a defense against a

1 manipulation.

2 COMMISSIONER O'MALIA: Let me move to
3 hedging. Last year following -- in the final rule
4 we had a petition by The Working Group that
5 enumerated ten specific hedge exemptions that they
6 were seeking. This year or this proposal we've
7 only included five of the ten. Why is that?

8 MR. SHERROD: In Section, I think it's
9 4a(c)(2) -- did I get that right -- did I get it
10 wrong? I think that's right -- Congress directed
11 the Commission to adopt a definition of bona fide
12 hedging. That definition is largely based on the
13 existing 1.3(Z)(1) but it varies in a few key
14 words. And so staff worked with the Commercial
15 Energy Working Group. We've been back and forth
16 with them numerous times to try to get real
17 examples of the risks, and not hypothetical
18 examples, and where we could identify examples
19 where they had real price risk, a real value
20 that's a value change and an asset, liability, or
21 some sort of service that they're providing. When
22 we could see those, then we drafted in additional

1 enumerated bona fide hedges to provide those
2 additional exemptions into this proposal.

3 COMMISSIONER O'MALIA: There's still a
4 petition process the same as it was in the
5 previous rule?

6 MR. SHERROD: The petition process is
7 basically statutory; it's self-effectuating. The
8 draft regulation basically points to the statutory
9 authority under 4a(a)(7).

10 COMMISSIONER O'MALIA: In the previous
11 proposal we had a reasonable certainty standard
12 allowing for an exemption in the case of
13 offsetting transaction where one is to complete
14 and the other is a reasonably certain to be
15 completed. We've taken that out of this draft.
16 Why is that?

17 MR. SHERROD: You know, my recollection
18 is, is we used the two words "reasonable
19 certainty" in only the examples in an appendix
20 that were trying to be illustrative of bona fide
21 hedges. So that reasonable certainty was never
22 explained as a policy position or a recommended

1 procedure. We were trying, by way of example in
2 appendices, to explain why someone who follows,
3 you know, the prior and the current regulation
4 guidance in, for example, regulation 1.48, who is
5 an anticipatory producer or has unfilled
6 anticipated requirements, why they would be
7 reasonably certain, and they would give us
8 evidence of that by saying, for the last three
9 years, here's what I produced or here's what I've
10 used in my production, manufacturing process, and
11 here is my expectation for the coming year. And
12 that was a way of shortcutting that regulatory
13 requirement by way of an example, but to my
14 knowledge it didn't appear in the preamble or any
15 of the regulatory texts in the vacated Part 151.

16 COMMISSIONER O'MALIA: Did we remove the
17 reasonable certainty because we removed
18 anticipatory hedging for merchandising?

19 MR. SHERROD: The vacated Part 151 rule
20 did provide -- it was not in the notice, but it
21 was in the final -- it did provide a hedging
22 exemption for unfilled storage capacity. We very

1 carefully reviewed the statutory requirements and
2 we are asking questions rather than providing that
3 proposal in the regulatory text.

4 At this time, we're unable to see a
5 price change in an unfilled storage bin that would
6 be in any way reasonably related to a calendar
7 month spread in one of any of a number of
8 commodities that might be stored in that unfilled
9 storage facility. And so, we've asked questions
10 in this preamble trying to solicit, you know,
11 hard, concrete examples of the pricing
12 relationships that would be consistent with a
13 statutory requirement.

14 COMMISSIONER O'MALIA: We've included
15 trade options as part of the position limit rule,
16 yet we didn't include a question whether they
17 should be included or not, we've just assumed they
18 should be included. This is an issue that end
19 users are struggling with to define that seven
20 part test, Part 7 is very difficult for them to
21 meet.

22 Would you have any objection -- or maybe

1 I should ask the Commission -- would the
2 Commission have any objection to adding a question
3 whether or not we should include trade options as
4 part of this rule or not -- as part of the
5 consideration of position limits? And how we
6 would do so under the seven-part test?

7 CHAIRMAN GENSLER: I'm guessing you're
8 still not going to vote for the rule?

9 COMMISSIONER O'MALIA: I asked the first
10 question. We can get to the second question
11 later.

12 CHAIRMAN GENSLER: I just thought I'd
13 have a little fun with you, Scott, I didn't know
14 -- I assume that you're not voting for it. But
15 assuming you're not voting for it, I still don't
16 have an objection to adding questions to a
17 proposal. It's seeking public comment.

18 COMMISSIONER WETJEN: I would just add,
19 I explored this issue with the staff too and as I
20 understood it, it's difficult to do it in this
21 document, although I would like to have the
22 question included only because it's a different

1 rule set that determines whether or not the trade
2 option should be included in position limits or
3 not. You know, I forget the exact rule number,
4 but if it's appropriate to include it here, I
5 would certainly support it.

6 CHAIRMAN GENSLER: And just let me -- on
7 this, trade options, if I remember, under the
8 seven part test, and so are swaps because Congress
9 says options are swaps in the statute, is that
10 correct?

11 MR. SHERROD: That's correct.

12 CHAIRMAN GENSLER: And so then I guess
13 really the question would be if you want to set it
14 up properly to allow the Commission an opportunity
15 under the Administrative Procedures Act to sort of
16 -- is there this form of a swap, call it trade
17 options, should that be excluded or exempted
18 somehow? I think that's what you're looking for.

19 COMMISSIONER O'MALIA: Well, I think
20 that everybody's struggling with is it a forward
21 or is it a trade option, and then if it is a trade
22 option, I understand -- if it is a swap, then I

1 understand why you might include it, but I think
2 people are trying to understand how they're going
3 to separate this from a forward or not.

4 CHAIRMAN GENSLER: So, is your --
5 because I'm trying to work with you to include a
6 question -- is your question, if it's a forward is
7 it included or --

8 COMMISSIONER O'MALIA: I would like to
9 just make sure that we work through this so we can
10 kind of make sure that this question is asked and
11 I think there are a couple of ways we can look at
12 it and ask possibly a couple questions around it,
13 but I think there's enough uncertainty around it I
14 think we'd want to frame it looking at it both
15 ways. If it is a trade option, how should it
16 count? If it's not, then, you know --

17 CHAIRMAN GENSLER: Right, but if it's a
18 forward it's out anyway.

19 COMMISSIONER O'MALIA: Well, that's
20 always the problem is, is it a forward or not, and
21 --

22 CHAIRMAN GENSLER: And I don't think, as

1 Commissioner Wetjen said, I don't think this
2 rulemaking will answer that, but I think you're
3 asking an additional question, which I would be
4 supportive of, even if it is a trade option, do we
5 ask some questions about would it be appropriate
6 to exempt it?

7 COMMISSIONER O'MALIA: And when do we
8 count it? And when do we count it? I mean, if
9 people are still trying to figure it out and we
10 have the optionality in the contract, do you count
11 it at the beginning where you're still uncertain
12 as a swap or not?

13 COMMISSIONER WETJEN: If we ask the
14 question here, perhaps it has to be answered in a
15 place other than the finalization of this rule,
16 but it probably would be valuable to get it out
17 there to get comment.

18 CHAIRMAN GENSLER: Steve, do you think
19 you have enough there to write a question?

20 MR. SHERROD: I think I do. I mean,
21 we've talked with a number of Commissioners and
22 your assistants about those that may, in the

1 industry, want to include trade options because
2 they're delta hedging with futures and then they
3 would automatically net down outside of the spot
4 month, so there are some that may wish to include
5 trade options and there are others who may be
6 holding inventory and writing trade options
7 against that inventory and then they would be kind
8 of required to file a bona fide hedging exemption.

9 And if trade options were out, they
10 would be off the hook from filing that bona fide
11 hedging exemption.

12 CHAIRMAN GENSLER: I think the nature of
13 the question is, to the extent that something is a
14 trade option you would note forwards are out
15 anyway -- we should affirmably make sure people
16 understand that -- but to the extent something may
17 be a trade option under the current rules and
18 regulation of the Commission, should we exempt,
19 either by -- any characteristic, participant or
20 other characteristic, some trade options, then
21 you'd have to raise a second question, I think,
22 because you're saying some people would want to

1 count them in and some people might want to count
2 them out and whether we'd even have that
3 authority, but you could ask some questions about
4 that.

5 MR. SHERROD: Right. So, we can
6 certainly draft that as a kind of 4a(a)(7)
7 exemptive authority that could be perhaps
8 discretionarily used by a person and claim the
9 exemption for trade options.

10 CHAIRMAN GENSLER: So, what I'm
11 suggesting is, following on this --

12 MR. SHERROD: Ask the question.

13 CHAIRMAN GENSLER: -- ask the questions
14 but do it enough, in a way, that under the
15 Administrative Procedure Act you leave flexibility
16 that in the final rulemaking the Commission could
17 figure that out.

18 MR. SHERROD: Right.

19 CHAIRMAN GENSLER: They can't answer the
20 question about forwards versus trade options,
21 which is really another docket.

22 MR. SHERROD: Right.

1 CHAIRMAN GENSLER: I don't know how I'm
2 going to do that, but maybe if I can ask for
3 unanimous consent to allow Steve to draft those
4 two questions that we just talked about. Absent
5 objection. Okay.

6 COMMISSIONER O'MALIA: Thank you very
7 much. That's all I had.

8 CHAIRMAN GENSLER: Thank you. And I do
9 want to just pause before I go to Commissioner
10 Wetjen. I do think we've made tremendous progress
11 that's been transformative in this swaps market
12 reform. There's now about \$400 trillion of data
13 in the data repositories of which just under \$2
14 trillion is in these physical commodity swaps. I
15 think the figures that were estimated recently,
16 Scott and Hannah, were about \$1.7 or \$1.8 trillion
17 notional.

18 But there's a lot of work to do. Scott
19 O'Malia is absolutely right and the staff is
20 absolutely right in the footnotes. We're still
21 getting a lot of data in under Part 20 and under
22 Part 45. Part 20 is the large data swaps

1 reporting reform; Part 45 is the swaps just
2 overall data repository reform.

3 We're still getting a lot of data in
4 that's not standardized enough. Frankly, it's not
5 compliant with our rules and though this
6 Commission and its staff have been looking at it,
7 we're resource constrained. John Rogers, the head
8 of our Data and Technology Office, has been
9 working, you've been working, Commissioner
10 O'Malia, through your tech advisory committee to
11 try to bring highlight on this. I mean, at some
12 point in time, this Commission will have to
13 determine whether we actually use our enforcement
14 authority. That hasn't been appropriate to date,
15 but just to really ensure that the data is coming
16 in a consistent way and a usable way for Federal
17 regulators.

18 So, I think -- I just want to ask, we've
19 left the flexibility that if by the time we
20 finalize there's some better standardization in
21 the data, we could shift from the method of data
22 that you have in there to the full use of Part 20,

1 is that correct?

2 MR. SHERROD: That's correct.

3 CHAIRMAN GENSLER: So, you've left that
4 flexibility in the final rules?

5 MR. SHERROD: Yes.

6 CHAIRMAN GENSLER: Okay. Commissioner
7 Wetjen?

8 COMMISSIONER WETJEN: Thanks, Mr.
9 Chairman. I just want to follow up on one of the
10 questions Commissioner O'Malia asked concerning
11 the process for seeking other hedges outside of
12 the enumerated hedges identified here. But before
13 I get to that, I just want to thank you, Steve,
14 and the rest of the team for accommodating some of
15 these questions around -- for now anyway -- staff
16 rulings on some specified enumerated hedges and
17 whether they would be permitted as such, and I
18 think while the staff is taking a view on that,
19 it's going to be helpful, I think, to get some
20 more comments and understand better whether or not
21 that's the appropriate treatment of those hedges.

22 But as far as going forward, and the

1 process laid out in this rule, I have some
2 concerns about it. The Chairman just alluded to
3 the fact that the Commission remains resource
4 constrained and we've all experienced in the last
5 two plus years now that once a rule has become
6 finalized, it's inevitable that a number of
7 questions come in from the market participants.
8 And I would expect that we would likely see that
9 here too at the point in time when this rulemaking
10 is finalized and decisions are made about which
11 enumerated hedges are permitted and which ones
12 aren't.

13 But if we get that decision wrong in the
14 final, I think it would be very valuable for the
15 Commission to retain as much flexibility as we can
16 in permitting additional appropriate,
17 non-enumerated hedges, and so the fact that, as I
18 understand it, the process and the rule lays out
19 something that's basically an exemptive process
20 that requires notice and comment, I worry some
21 that that might be -- that might not have the
22 flexibility and the timeliness that perhaps the

1 marketplace deserves, and if we're most interested
2 in liquidity and price formation in these markets,
3 I wonder if a rigid, less flexible process could
4 stand in the way of that.

5 So, I want to make those comments and
6 then point out that, with your assistance, Steve,
7 we were able to get some questions in the release
8 today that asked for additional comment on that as
9 well. So, I look forward to hearing what the
10 comment letters say on that score.

11 The other issue I wanted to ask about
12 was -- or talk a little bit about is daily
13 reporting. We've talked now about Part 20 and
14 Part 45. Is there any other specific daily
15 reporting requirement in this rule -- proposed
16 rule before us today? You and I talked about
17 this, Steve, in the last couple of days.

18 MR. SHERROD: The bona fide hedge
19 exemptions would follow the existing reporting
20 format. So, by way of example, with Form 204,
21 someone relying upon a bona fide hedging exemption
22 would file as of the last Friday of the month,

1 their positions in cash inventory and fixed price
2 purchase, fixed price sales that are forward
3 contracts. Each of those persons, though, already
4 have an obligation to the extent they're
5 reportable traders, to keep complete books and
6 records so the Commission staff is able to look at
7 those for any particular day where they're
8 reportable, and the reportable levels are much
9 lower.

10 This varies from the requirement that
11 would have required someone to report, for
12 example, their cash inventories on a daily basis
13 on each day, and I think it's consistent with the
14 current practice where if someone reasonably can
15 rely upon their inventory as a basis of their bona
16 fide hedge and they haven't sold that inventory,
17 there's kind of no pressing need that I can see to
18 recount it every single day.

19 COMMISSIONER WETJEN: But isn't there,
20 under Part 19 of today's release, I believe there
21 is a daily reporting requirement for those that
22 have exceeded the conditional spot month limit,

1 isn't that right?

2 MR. SHERROD: That's right, and the
3 conditional spot month limit exemption would allow
4 -- it's the way the release is structured, there's
5 a baseline proposal in the regulatory text that
6 would allow a trader that's only in cash settled
7 contracts to have an exemption to be five times
8 larger than the spot month limit if they stay out
9 of the physical delivery contract.

10 When they relied upon that exemption for
11 a commodity identified by the Commission as a
12 special reporting category, an initial one would
13 only be natural gas, then by every day it -- the
14 next day at 9:00 a.m., the next morning, they
15 would have to report to the Commission their cash
16 market inventory and their forward purchases and
17 sales in the delivery location for the particular
18 Henry Hub natural gas contract.

19 There are some alternatives to that
20 proposal that are drafted in as questions. Those
21 alternatives would include limiting the sort of
22 conditional spot month limit exemption to a cash

1 settled contract, for example, that cash settles
2 only to an index of cash market transaction prices
3 and not to the physical delivery core referenced
4 futures contract.

5 So, there are a variety of different
6 alternatives and we've recommended the Commission
7 seek comment on those different alternatives.

8 COMMISSIONER WETJEN: So, it's at least
9 possible that the burden of daily reporting under
10 Part 19 can be diminished even further depending
11 on how the rest of the proposal is changed at the
12 final rule stage, correct?

13 MR. SHERROD: That's correct, and
14 historically, as Lee Ann mentioned, there has been
15 a lot of volatility in natural gas trading and so
16 the Commission staff has recommended for that
17 particular commodity that if the zero five -- as
18 we style it, no position in the physical delivery
19 and five times in the cash settle contract -- if
20 that is approved in a final rule, then we
21 recommend that daily reporting of the cash market
22 transactions and inventory in natural gas.

1 COMMISSIONER WETJEN: Does Table 11
2 provide that outside of the energy contracts, does
3 it provide that there would be any reporters that
4 would have to undertake this daily reporting
5 obligation under Part 19 based on what we know
6 today and reflected in Table 11?

7 MR. SHERROD: No, it does not. The only
8 one we recommend is natural gas. As we gain
9 experience, if the rules go into place and we see
10 volatility in trading, perhaps we see aggressive
11 trading in the cash markets pursuant to special
12 calls, then we would come back to the Commission
13 and recommend expanding the scope of that
14 reporting.

15 COMMISSIONER WETJEN: Thank you, Steve,
16 that's all I have.

17 CHAIRMAN GENSLER: I just wanted to take
18 a moment to come back. I misspoke. There were
19 130 studies listed, but it was actually the
20 Federal Reserve Bank of Dallas, October 2011. It
21 wasn't so much a study, it was a note that they
22 put out, and it probably fell in that third

1 bucket, which was inconclusive, but nonetheless
2 maybe we list that Dallas Fed note from October
3 2011. I also just -- I'm going to try out some
4 words. They're not anything different than I said
5 before, but on that page 56 -- and maybe I'll ask
6 unanimous consent, but just while there's not a
7 consensus -- referencing the studies -- while
8 there's not a consensus, the fact that these
9 studies are on both sides in the Commission view
10 warrants erring on the side of caution. I mean,
11 that's how I was trying to articulate it.

12 So, absent objection, I would just try
13 to add that on page 56.

14 COMMISSIONER WETJEN: Mr. Chairman,
15 before -- given the opportunity to make
16 statements, I mentioned that I was going to just
17 have for the record what I prepared today, but
18 since you mention this issue about the
19 underpinnings for the mandate, I just want to
20 point out to the public, I spent a considerable
21 amount of time talking to our litigation team and
22 our advisors on this very issue and so there's a

1 considerable discussion of that statement. But I
2 appreciate you talking about that some here today.

3 I'm looking forward to additional
4 comments on that during the comment period.

5 CHAIRMAN GENSLER: And I think -- though
6 I didn't necessarily agree with the District Court
7 Judge, Judge Wilkins, I think what we have here in
8 front of us is a very well researched and buttoned
9 down and proposed rule, but it also leaves a great
10 deal of flexibility because it highlights, as you
11 were highlighting, in the cash settled area, cash
12 settled spot, a series of questions. We just
13 added some questions on trade options, but we have
14 a series of questions that really say the
15 Commission is open to considering alternatives,
16 whether it's on cash settled spot month limit,
17 with regard to trade options, but then in a host
18 of other areas, really, with regard to this.

19 So, I think whether it will be 8,000 or
20 15,000 comments this time around, there will be
21 thousands of comments that come in based on this.
22 Melissa?

1 MS. JURGENS: This is a vote on the
2 notice of proposed rulemaking for position limits
3 for derivatives. Commissioner Wetjen?

4 COMMISSIONER WETJEN: Aye.

5 MS. JURGENS: Commissioner Wetjen, aye.
6 Commissioner O'Malia?

7 COMMISSIONER O'MALIA: No.

8 MS. JURGENS: Commissioner O'Malia, no.
9 Commissioner Chilton?

10 COMMISSIONER CHILTON: Oh yeah.

11 MS. JURGENS: Commissioner Chilton, aye.
12 Mr. Chairman?

13 CHAIRMAN GENSLER: Aye.

14 MS. JURGENS: Mr. Chairman, aye. Mr.
15 Chairman, on this matter, the ayes have three, the
16 nos have one.

17 CHAIRMAN GENSLER: Bart, do you want to
18 take the Chair for 30 seconds to do the usual
19 stuff I do right now to react to that vote count?

20 COMMISSIONER CHILTON: Yeah. With that,
21 it is approved. Thank you, Mr. Chair.

22 CHAIRMAN GENSLER: And we'll send it to

1 the Federal Register.

2 With that, there's a second rule. It's,
3 by and large, the same people at the table. If
4 you could give a brief summary on the aggregation
5 proposals, do I see some people coming --
6 exchanging seats? Maybe Mark Fajfar is coming up
7 from the General Counsel's office.

8 And you can feel free to keep this
9 brief. I think that this is well understood by
10 the Commission.

11 MR. FAJFAR: We'll go quickly. Good
12 morning.

13 CHAIRMAN GENSLER: That was a hint.

14 MR. FAJFAR: Staff is presenting for the
15 Commission's approval proposed amendments to the
16 current account aggregation standards. These
17 amendments are substantially similar to the
18 aggregation modifications that the Commission
19 proposed in May 2012 but were not finalized before
20 Part 151 was vacated.

21 The amendment presented today would
22 permit four additional exemptions from aggregation

1 where, first, the sharing of information that goes
2 along with aggregation would violate or create a
3 reasonable risk of violating Federal, state, or
4 foreign law or regulation, second, where there's
5 an ownership interest of no more than 50 percent
6 in an entity whose trading is independently
7 controlled, third, where there is an ownership
8 interest of more than 50 percent in an entity that
9 is not consolidated and whose trading is
10 independently controlled, and the applicant
11 certifies that the position is either qualified as
12 bona fide hedging or does not exceed 20 percent of
13 any position limit, and fourth, where there is an
14 ownership interest of no more than 50 percent in
15 an entity by a broker dealer resulting from its
16 normal course activities.

17 We're suggesting these four aggregation
18 amendments separately from the other amendments of
19 the position limit regime in order to allow the
20 Commission, in its discretion after reviewing the
21 comments, to adopt these modifications separately.
22 Although these aggregation amendments are

1 consistent with the other position limit
2 amendments, they could be adopted either together
3 or separately.

4 I'll just briefly go through the history
5 of the aggregation rules and the changes that were
6 proposed last year.

7 The Commodity Exchange Act requires the
8 aggregation of all positions which a person owns
9 or controls and all positions of persons acting
10 pursuant to an express or implied agreement or
11 understanding. The Commission's current
12 regulations include a requirement that a person
13 aggregate all positions for which it has a 10
14 percent or greater ownership interest.

15 Regulations also provide exemptions for
16 eligible entities with independent account
17 controllers.

18 When the position limit regime in Part
19 151 was adopted, exemptions were added for
20 information sharing that would cause a violation
21 of Federal law or regulations and foreign
22 underwriters' ownership of an unsold allotment of

1 securities.

2 As I said, in May 2012, the Commission
3 proposed changes to the aggregation rule that
4 remain part of what we're proposing today. The
5 first change proposed in May 2012 would allow a
6 person to disaggregate the positions of a
7 separately organized entity even if it had a 10
8 percent or greater ownership interest, but so long
9 as it had no more than a 50 percent ownership
10 interest, and if the person filed a notice
11 demonstrating lack of control.

12 Another change that was proposed would
13 make the information sharing exemption available
14 where there is a reasonable risk of violating or
15 an actual violation of Federal, state, or foreign
16 law.

17 Other changes proposed in May 2012 would
18 allow higher tier entities to rely upon exemption
19 notices, provide an exemption in certain
20 circumstances for broker dealers, and they allowed
21 commodity pools established as limited liability
22 companies to be treated the same as limited

1 liability partnerships.

2 Staff considered the public comments on
3 the May 2012 proposal in developing the amendments
4 suggested today. We've retained the essence of
5 the earlier proposal with the addition of the
6 following elements based on those comments and the
7 staff's further consideration.

8 Today's proposal includes a provision
9 that would permit the owner of more than 50
10 percent of another entity to apply to the
11 Commission for relief from aggregation on a
12 case-by-case basis. This reflects a view that in
13 some limited situations, disaggregation relief may
14 be appropriate even for majority owners if the
15 owned entity is not required to be and is not
16 consolidated on the financial statement of the
17 owner, if the owner can demonstrate that it does
18 not control the trading of the owned entity, and
19 if both the owner and the owned entity have
20 procedures in place that are reasonably effective
21 to prevent coordinated trading.

22 Additionally, the owner must certify

1 that either all the owned entity's positions
2 qualify as bona fide hedging, or the owned
3 entity's non-hedging positions do not exceed 20
4 percent of any position limit.

5 This proposed relief would not be
6 automatic, but would be available only if the
7 Commission finds in its discretion that all the
8 conditions are met. The proposed rule would not
9 impose any time limits on the Commission's process
10 for making the determination of whether relief is
11 appropriate and relief would be available only if
12 and when the Commission acts on a particular
13 request.

14 We note that if a majority owner could
15 not meet all the conditions in the proposed rule,
16 it could apply to the Commission for relief from
17 aggregation under Section 4a(a)(7) of the
18 Commodity Exchange Act.

19 Lastly, today's proposal also includes
20 an amendment that would allow managers of employee
21 benefit plans to be treated as independent account
22 controllers, and we'd like to emphasize that this

1 proposed relief would be limited to employee
2 benefit plans.

3 Regarding broker dealers, this proposal
4 includes an exemption for ownership of no more
5 than 50 percent of an entity resulting from dealer
6 activities in the normal course.

7 And finally we note that in connection
8 with these proposed amendments, the staff reviewed
9 the wording of the existing regulations and noted
10 certain instances where they may be unclear.
11 Therefore the amendments put forward today include
12 a reorganization of the rule for clarity that is
13 not intended to effect any substantive change.

14 We invite commenters to address whether
15 this reorganization is accurate and helpful. And,
16 as is the case for all proposed rules, the staff
17 welcomes comment on all aspects of the proposed
18 changes to the aggregation rules for the position
19 limits regime. We're available to answer any
20 questions.

21 CHAIRMAN GENSLER: Entertain a motion to
22 accept the staff recommendation on aggregation for

1 purposes of position limits?

2 COMMISSIONER CHILTON: So moved.

3 COMMISSIONER O'MALIA: Second.

4 CHAIRMAN GENSLER: I support this
5 proposed rule to modify the aggregation provisions
6 for limits on speculative positions, and I'll have
7 a statement for the record, but just trying to put
8 it in the simplest terms, market participants in
9 this day and age often trade through many legal
10 entities, sometimes hundreds, in fact, thousands
11 of legal entities. I've noted a few times when
12 Lehman Brothers failed, they had 3,300 legal
13 entities within their corporate family.

14 And so the question comes up in so many
15 of our rules and so many of our efforts, if
16 there's a requirement on one part of a corporate
17 family, how does that relate to the rest of the
18 corporate family? And here where Congress has
19 mandated for us to move forward on limiting
20 certain participants in the market in terms of the
21 size of their position, and you can quickly see
22 it's just a matter of arithmetic the question

1 comes, do you count all those 3,300 legal entities
2 that Lehman Brothers once controlled or do you
3 apply a limit just for each and every one of the
4 3,300?

5 We chose the second, that you had a
6 limit on each of the one out of 3,300, and yet
7 they were owned and controlled by the same people,
8 that would sort of be -- excuse the expression --
9 but a runaround of Congressional intent, and also
10 wouldn't really help the market integrity that
11 we're trying to help.

12 So, that's where this issue of
13 aggregation comes into being. We have similar
14 issues of aggregation throughout our rulewriting,
15 but that's why it comes right here where there's a
16 limit.

17 I think that when we finalize the rules
18 that were subsequently vacated by the court, we
19 had some more work to do, and in May of 2012,
20 before any judge vacated the rules, we as a
21 Commission -- I think it was unanimous actually at
22 the time -- decided to put out to further comment

1 new approaches and reforms on aggregation. And I
2 felt those were very balanced. Really, what if --
3 I've used the Lehman Brother example -- what if
4 Lehman Brothers only owed 10 percent of some
5 company and they didn't really direct its trading,
6 they didn't control it's trading, they maybe owned
7 it in what's called their private equity
8 investing, which was allowed then, should that
9 come into this aggregation, and so forth?

10 And I'm fortunate we got 26 public
11 comment letters. It was not measured in the
12 thousands, but 26 public comment letters, and we
13 made some additional modifications, and that's
14 what is embodied here.

15 I do think, though, it's important that
16 we don't loosen these things up so much that all
17 the sudden Lehman Brothers' 3,300 companies could
18 have all been separate. I do think this basic
19 tenet that there has to be aggregation under
20 position limits is critical if these regimes have
21 any meaning.

22 So, I don't have any questions, but I

1 want to turn it to Commissioner Chilton.
2 Commissioner? Wow. Melissa? May you call the
3 vote.

4 MS. JURGENS: This is a vote on the
5 notice of proposed rulemaking for aggregation of
6 accounts under Part 150 position limits.
7 Commissioner Wetjen?

8 COMMISSIONER WETJEN: Aye.

9 MS. JURGENS: Commissioner Wetjen, aye.
10 Commissioner O'Malia?

11 COMMISSIONER O'MALIA: Aye.

12 MS. JURGENS: Commissioner O'Malia, aye.
13 Commissioner Chilton?

14 COMMISSIONER CHILTON: Aye.

15 MS. JURGENS: Commissioner Chilton, aye.
16 Mr. Chairman?

17 CHAIRMAN GENSLER: Aye.

18 MS. JURGENS: Mr. Chairman, aye. Mr.
19 Chairman, on this matter, the ayes have four, the
20 nos have zero.

21 CHAIRMAN GENSLER: The vote being
22 unanimous, the staff recommendation is approved

1 and will be sent to the Federal Register for
2 public comment.

3 Are there other matters? Commissioner
4 O'Malia?

5 COMMISSIONER O'MALIA: Could you help us
6 understand the timeframe for the cross-border
7 discussion and how we're going to do the
8 determinations, include input from the relevant
9 jurisdictions, have the time to review all of
10 that, review the MOUs of supervisory MOUs, and
11 make a determination by December 21st when we have
12 yet to see any paper on this, aside from the 88
13 page comparison of their rules and our rules, but
14 they have not had the opportunity -- my
15 understanding, they're reviewing that, but we
16 haven't received their response.

17 CHAIRMAN GENSLER: We will make this
18 work before December 21st. We've had very good
19 dialogues and discussions with each of the six
20 jurisdictions. They have asked us to share with
21 them, as we have, our, what I would call, side-
22 by-sides on various entity-level requirements for

1 swap dealers -- reporting swap dealer business
2 management or as it's called, risk management,
3 chief compliance officer, and the like.

4 We're starting that feedback. I think
5 the conclusion of that feedback will be this
6 Friday, if I recall, but you know, we set some
7 tight deadlines. Those documents are also in all
8 the Commissioners' hands. To the extent you have
9 input from those side-by-sides, Frank Fisanich,
10 and the Division of Swap and Intermediary
11 Oversight, and of course, Sarah Josephson, head of
12 our international effort, Carlene Kim from the
13 General Counsel's office, are all working on the
14 documentation for Commission determinations.

15 On some of the data side, Vince, I
16 guess, Stuart, if I remember?

17 MR. MCGONAGLE: That's correct.

18 CHAIRMAN GENSLER: You might say for the
19 record Stuart's last name. I'm sorry.

20 MR. MCGONAGLE: Armstrong.

21 CHAIRMAN GENSLER: Stuart Armstrong if
22 people want to contact him -- are working on that

1 as well. Based on that feedback from the various
2 international regulatory regimes in these six
3 jurisdictions, the staff will turn around and get
4 into each of the Commissioner's hands documents
5 later this month, but I encourage input, feedback,
6 on the side-by-sides that already occurred, and
7 feedback to any one of the staff would be very
8 helpful with this regard.

9 COMMISSIONER O'MALIA: And Volcker is
10 still on track, 1000 pages -- we haven't seen?

11 CHAIRMAN GENSLER: You know, I can
12 always rely that we have a very open and lively
13 Commission meeting. I recommend it, by the way,
14 to any other regulatory commissions, because this
15 is a good part of democracy.

16 Where we -- yes.

17 COMMISSIONER WETJEN: I'm sure they
18 would take your advice, Gary, I'm certain of it.

19 CHAIRMAN GENSLER: I was just wondering
20 if you thought it was a good part of democracy.

21 On the Volcker Rule, this is one of the
22 most challenging rules. We, as a Commission, I

1 think, have finalized for Dodd-Frank 65 or 66
2 rules and guidances. I think, from my own
3 perspective, this is one of the most challenging
4 because banning proprietary trading, that which
5 Congress decided to do to lower the risk to the
6 American public of bank entities failing, while at
7 the same time permitting market making to help the
8 markets work, permitting hedging, underwriting,
9 and so forth, it's a matter of sort of borders and
10 boundaries and where they overlap.

11 And I'll just use one example. Market
12 making is permitted. Somebody walks in with a
13 position, a million shares of IBM stock and needs
14 to sell it, that would be a large position, you
15 could buy that, but at the same time, proprietary
16 trading is banned. So, how long can somebody hold
17 that position -- a banking entity -- until they --
18 it's really a proprietary position? I think
19 probably everybody would agree, if you held it for
20 five years and it was unhedged, that's gone from
21 market making on day one, and sometime it's become
22 a proprietary position that even starts to grow

1 some mold on it at some point.

2 And having worked at investment bank for
3 -- what was it -- 18 years, in my case, there were
4 some positions that really did move from a market
5 making desk and just stay for a long time.

6 And in the derivatives space, this is
7 even more interesting because many of the
8 customized, uncleared swaps will stay on the
9 balance sheets of large banking enterprises for
10 years, maybe up to 30 years. So, as they stay
11 there, how do they hedge them? And it would be
12 appropriate to hedge them.

13 I've just sort of recognized some of the
14 challenges. There's been some very good work.
15 The document is moving along. We don't have, as
16 an agency, a finalized document. If we were to
17 schedule a vote the second or third week of
18 December, I've indicated to all of my fellow
19 regulators that we stand pretty strong that it's
20 got to be a pens down version to all of this
21 Commission three weeks before, but preferably a
22 lot before that.

1 But we're no longer in the "lot" before
2 that. Because that really only gives us about two
3 weeks to get a pens down version to all of you and
4 get your feedback and input and so forth.

5 But that's where we are.

6 COMMISSIONER O'MALIA: Well, we do --
7 you know, the words are going to matter, and with
8 all due respect to your example, we want to see
9 all the words.

10 CHAIRMAN GENSLER: I agree with you. In
11 fact, I think the words matter so much here.
12 Commissioner O'Malia and I will agree on this.
13 The words matter so much here. You could write
14 the words where the Volcker Rule would have very
15 consistent meaning to what Congress intended. You
16 can write the words that the market making -- for
17 instance, if you could continually market make and
18 add to your positions over years and never sell
19 them, then you, in essence, have no Volcker Rule.
20 So, the words very much matter.

21 COMMISSIONER O'MALIA: We just need them
22 in time --

1 CHAIRMAN GENSLER: All right.

2 COMMISSIONER O'MALIA: -- and
3 considering the workload that we have with
4 substituted compliance and -- these are as complex
5 subjects as any that we've contemplated, so we
6 just need plenty of time to get these things done.
7 I'm not trying to delay, I just don't want to be
8 caught in a position that we can't reasonably get
9 through 1,000 or 2,000 pages of documentation.

10 CHAIRMAN GENSLER: I share your view
11 about the challenges of this one. Commissioner
12 Chilton?

13 COMMISSIONER CHILTON: I just want to
14 make a quick comment on this. Here's a problem:
15 Volcker said that you couldn't do proprietary
16 hedging. I wrote to Chairman Bernanke a year ago
17 September, I wrote to him again -- and other
18 regulators -- I wrote to him again in September of
19 this year -- August of this year, and the deal is,
20 can you -- I mean, we know something about
21 hedging. There's a lot in the Volcker Rule that
22 we're not the expert regulator. On hedging, we're

1 the expert regulator and we should, all of us,
2 figure out what that language is because what the
3 bank holding companies and others will do is they
4 will try to say that their hedge is a speculative
5 -- or they'll try to say their speculative
6 position is a hedge.

7 That will happen unless we have this
8 language tight. So, of all the things that may be
9 in the Volcker Rule, to me, that's the one where
10 we need our advice to ensure that we're being true
11 to the law. Thanks.

12 CHAIRMAN GENSLER: Something short,
13 Commissioner Wetjen? No. All right. Again,
14 before we adjourn, I want to thank Commissioner
15 Chilton. I know this has been a remarkable
16 journey, not just on position limits, but on
17 everything you've done to look out for the public,
18 to look out for the investor with your eye on the
19 ball of reform. You've been also, if I can say, a
20 remarkable partner and I remember the first time
21 that we chatted during the Presidential
22 transition; you gave me advice on actually my

1 confirmation. At that stage I needed all the
2 advice I could get, and I really do appreciate on
3 that advice all the way through advice you gave me
4 this morning.

5 So, I want to thank you. With that,
6 I'll entertain a motion to adjourn.

7 COMMISSIONER CHILTON: So moved.

8 COMMISSIONER O'MALIA: Second.

9 CHAIRMAN GENSLER: Second. Thank you.

10 (Whereupon, at 11:39 a.m., the
11 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Christine Allen, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: January 14, 2017

