THIRD WAY

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Demystifying Derivatives Reform

Third Way

Introduction:

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JIM KESSLER: Good morning, everybody. Let's get started. So, thank you for coming. It's a huge crowd. We normally have a bigger room. This was the room we could get. And this is like a Springsteen concert. Like, everybody is – (laughter) – everyone's here.

In 1979 I was a freshman at Boston University. And I was the head of the social committee in my dorm, which was an elected position. And I scheduled a Q&A session with the president of Boston University at the time. His name is John Silber. And I scheduled it months in advance. You know, there was nothing special about that date, but by chance the day that he showed up was the day before Boston University professors were scheduled to go on strike. And suddenly there was a lot of interest in what John Silber had to say.

About six months ago, Third Way, through our Capital Markets Initiative program, we invited Chairman Gensler to address Capitol Hill staffers, and by chance the day we settled on happened to be two days before the CFTC issues a proposed ruling on cross-border derivatives. So suddenly there's a lot of interest – (laughter) – in what he may or may not say.

My name is Jim Kessler. I'm the senior vice president for policy at Third Way. Third Way's Capital Markets Initiative was started two years ago to basically help translate the arcane world of capital markets to people on Capitol Hill.

My view, perhaps more than any other issue this is – I think it's the steepest learning curve. You know, more than national defense, more than taxes, more than health care, financial issues are extremely complex. And then, you know, derivatives, even for people steeped in the financial markets, they're doubly complex. And our guest today, CFTC Chairman Gary Gensler, will discuss the CFTC's role in reforming the derivatives markets in the wake of the financial crisis.

Chairman Gensler has headed the CFTC since 2009. Prior to that, in the '90s he served in the Clinton administration at the Treasury Department under both Secretaries Rubin and Summers. He was the senior advisor to the Senate Banking Committee chairman, Senator Paul Sarbanes. And prior to that he worked on Wall Street at Goldman Sachs. He was the co-head of finance when he left there, which is a very, very big deal. And during his spare time he managed to write a book called "The Great Mutual Fund Trap: An Investment Recovery Plan."

As we work through an array of post-crisis regulatory changes, Chairman Gensler has played a leading role in these efforts. We're thrilled to have this Baltimore native, this Ravens fan, this Orioles fan to join us here today. We look forward to him sharing his thoughts. He's going to speak for 15 or 20 minutes and then he's going to take questions, so be ready with your questions.

Chairman, thank you so much. (Applause.)

GARY GENSLER: Jim, I want to thank you for that kind introduction. And I didn't know when I was invited that it would be such an interesting time in the life of the Commodity Futures Trading Commission, but nor did I know that you had gone to Boston University. And my eldest daughter – I'm a dad of three – my eldest just graduated Boston University.

MR. KESSLER: Congratulations.

MR. GENSLER: Those red gowns, though. They've got to do something with that there.

MR. KESSLER: And that tuition price. (Laughter.)

MR. GENSLER: That's another thing.

I was going to just chat a little bit about reform and why reform matters so much. And this reform I'm talking about is the swaps market.

2008, of course the financial system failed, but it was also the financial regulatory system that failed. Middle-class Americans paid for this crisis with their jobs, with their pensions, with their homes. We lost 8 million jobs and thousands of businesses shuttered, and of course millions of Americans were out of their homes.

The unregulated swaps market was one of the central causes of the crisis. It's not the only. There were many other things going on – the housing bubble and elsewhere. But it was certainly one of the causes of the crisis. Furthermore, it was financial institutions operating complicated swaps businesses in their offshore entities. I mention that given the week and what we're doing at the CFTC, but it was really these offshore entities and the interconnectedness of these global institutions that helped nearly topple the U.S. economy.

Five years later where we are is market participants are coming into compliance with the commonsense rules that Congress passed in Dodd-Frank. What did Congress lay out?

They really just laid out reforms to promote transparency and to protect the public. The large international banks, though, have had some suggestions for the Commodity Futures Trading Commission, as you can imagine. Some of them probably have their representatives in the room, and I welcome you. (Laughter.) But they have had a few suggestions for us as we try to finalize guidance on something called the cross-border application of reform.

Now, I just want to pause for a minute just because there's probably variety of people here. What is a swap? My mom in Baltimore – she's 86 – she sometimes asks me, Gary, what is this thing that you do? And if I didn't have my three daughters to keep me humble, my mom certainly does.

But swaps and futures are derivatives. They derive their value from something else. That's what this word "derivative" means. But they're in essence used and have been used for at least 150 years to help a producer or a merchant, a business, a city to lock in a price or a rate. Initially – and they were invented in the 1860s around Civil War time – it was to help a farmer or rancher to lock in the price of corn or wheat at harvest time. They wanted to focus on what they knew best, plowing the field and getting the most out of their crops, but lock in the price.

You fast-forward to today and of course it's to help businesses to lock in an interest rate, to lock in a currency rate when you are importing goods from around the globe, or exporting – hopefully more exporting than importing – but to lock in a rate or still to lock in the price of oil or natural gas and so forth. So they're integral to our economy, and by the way they're a big market. It's $300 trillion of swaps and probably about 30 (trillion dollars) to $40 trillion of futures.

If you add it all up, that's 20 (dollars) to $22 of derivatives in the United States for every dollar of goods and services. So if you fill up a tank of gas for $75, you can think somewhere in the economy there's probably about $1,500 of derivatives backing that somewhere in the economy. So that's my little bit on derivatives.

But Congress came together in Dodd-Frank and I think clearly said that swaps reform does need to happen for transparency and for lowering the risk to the American public, but they included some really critical words where they said that swaps reform does apply to activities outside of our borders, using the words “it applies when there is a direct and significant connection with activities in, or effect on” – and it does say “or.” So it’s “connection with activities in, or effect on commerce” here in the U.S.

A lot of banks knocked on our door two-and-a-half years ago and said, can you help us out and interpret these key 16 to 20 words in statute? And Jim decided he thought it would be a wry sense of humor to invite me here to speak two days before the deadline.

I think Congress did this knowing that risk knows no geographic border, or boundary. Risk from our housing crisis and financial crisis contributed to the economic downturn around the globe. Our risk spread around the globe. But also risk comes crashing back here to our shores from our overseas affiliates of financial institutions when a run starts anywhere. If a run starts in a modern global financial institution, it can come back here. This reality played out time and again during and since 2008.

Let me just lay out a little bit of what we’ve done, with Congress’ help, to make the system better, but it’s also to lay out what’s at stake.

The CFTC has completed pretty much all other rules – I’ll say 90-plus percent of the rules. Congress laid out in the law 50 to 60 places where we affirmatively had to write a rule and get the job done. We’ve completed 56 actually. We have a handful left but we’ve completed them. And what did they cover?

No longer will the market be closed and dark. Transparency is actually becoming a reality in the market. As a result of the reforms that we’ve put in place already, regulators are seeing the transactions for the first time. This started at the end of last year. Starting December 31st of last year, all the trades need to go into trade repositories for the regulators to see. And it was phased in. There's still some phasing to go, but over the last seven months that's become a reality.

But in addition to that, Congress said clearly the public had to have transparency. So again, starting last December 31st there started to be public reporting. You can think of it like a ticker tape for this esoteric product called swaps, first with the time delay of between 30 minutes and 48 hours, but the price and volume of swaps are now public. And then it phases in that some of it will actually be real-time reporting as soon as technologically practicable.

And lastly on transparency, we also finalized rules about two months ago for new trading platforms called Swap Execution Facilities. Why was this important? Why did Congress include it in the law? It was really to bring the commonsense reforms from the securities and futures market that when buyers and sellers meet, if they meet in a competitive, transparent trading venue, it's more likely that the broad public benefits by that additional competition in the marketplace. We've completed all those rules, but frankly they're at stake if we do not pay attention through the cross-border rules.

Second thing that we've completed and becoming a reality is something called clearing. Broad market participation in central clearing has become a reality. What's central clearing? It's an invention of the 1890s. It's not a new thing that Congress took up in Dodd-Frank. It really says that when you enter into one of these derivatives transactions, on a daily basis you have to value it, on a daily basis there's somebody that stands between two parties in case one of them goes bankrupt. And a central clearinghouse was a way in the 1890s literally to clean up a back-office mess that was happening in the then-derivatives market called futures.

Well, we had a bit of back-office mess, I would say, over the last 10 years, and part of that led to the 2008 crisis, and Congress responded and said, let's take that old feature of central clearing and bring it to this newer market swaps. We completed all the rules that Congress asked us to do in 2011 and 2012. We phased the implementation, and as of today there's a mandatory required clearing for four big interest rate curves – the U.S. dollar and the euro, the yen and sterling, and the big credit derivative indices that were at the center of last year's JP Morgan, London Whale situation, just to use as an example. That clearing requirement has become a reality and has been phasing in. There's still one more phasing date in September.

Thirdly was the swap dealer, somebody dealing with the public, had to also be overseeing. Many of these dealers are banks, but Congress took a look at it and said, though they're covered as banks, one of the assumptions of the 1990s proved to be – proved out poorly. It was, well, we regulate them as banks or we regulate them as insurance companies; we don't have to regulate their activity.

AIG is one of the examples where it didn't prove out so well, but I think when Congress took a look at this they said, no, we have to have a registration requirement that these dealers need to register. And what do they register for? They register for business conduct, sales practice and back office sort of cleaning up the spaghetti wire of the back office, but also that they have sufficient capital to stand behind the trades.

We finished those rules about a year to a year-and-a-half ago, and as of December 31st dealers started registering. And as of this week I think we have 81 registered swap dealers, and something else called a major swap participant. But of those 81 institutions, a little over 30 are actually international enterprises, so about give or take 45 or 50 are U.S. and 30 to 35 are international. It includes all of the banks that you would think, what's called the "group of 16," the largest 16 banks, the $2 trillion club, if you wish, because most of these banks do have balance sheets that are that big.

And most of these banks that have registered have swaps businesses that don't measure in the millions or billions but they measure in the trillions, and the largest ones have portfolios that range between 20 (trillion dollars) and 60 trillion dollars each in the derivatives business. They now register with the CFTC. They are under Dodd-Frank reforms.

Now, all of these commonsense reforms Congress has mandated, however, could be undone if the overseas guaranteed affiliates and branches of U.S. persons are allowed to operate outside of the requirements. Why is that? The nature of modern finance is that financial institutions commonly set up hundreds if not thousands of legal entities around the globe. The biggest U.S. enterprises today generally have between 2,000 and 3,000 legal entities.

Now that's progressed. I left Wall Street 15 years ago – 16. When I left a small firm in New York we had 700 legal entities. So that was 1997. But the large institutions generally have between 2(,000) and 3,000. Lehman Brothers failed. They had 3,300 legal entities spread around the globe. Some institutions have hundreds of legal entities in the Cayman Islands alone – which is a wonderful place to visit, by the way, and the tortoises and the stingrays are fun. (Laughter.) But unfortunately their regulatory regime down in the Cayman is not quite what it is in Europe or the U.S.

So if a run starts anywhere on an overseas affiliate or branch of modern financial institutions, risk comes crashing back here. That's because if a run starts somewhere, everywhere around the globe people dealing with that bank – any one of the 3,000 legal entities – they want to get out of the way. They do not want to be a counterparty. They don't want to be on the other side of that transaction.

It is just – you know, you don't want to wake up Monday morning after the crisis weekend – the crisis weekend is when a bunch of people go into that big building up in New York called the New York Fed and they try to sort out what the mess is going to be, or they sort it out over at the Bank of England. But what happens on Monday morning is a great deal of uncertainty and a bank has failed, and all around the globe all 2,000 or 3,000 of their legal entities, there's a run on them.

Lest we forget AIG – that nearly brought down the U.S. economy – AIG Financial Products was run out of London in the neighborhood of Mayfair and it had a branch banking license out of France. Contributing to its overseas operation, it was guaranteed back here in the U.S. Lehman Brothers, as I said, had 3,300 legal entities. It's one legal entity in the U.K., Lehman Brothers, International, had 130,000 outstanding swaps, and they were all guaranteed by the mother ship back here at home.

Citigroup set up numerous structured investment vehicles that if – those of you that remember 2007, Secretary Paulson was trying to figure out how to do some fix to bring some support to them. Citigroup actually had guaranteed these through something called a liquidity put, but these special-purpose vehicles were all incorporated in the Cayman Islands.

Need I go on and on – Bear Stearns, you might remember that. In 2007 their hedge funds that they were operating incorporated in the Cayman Islands. A decade earlier, Long-Term Capital Management was a hedge fund operated and run and sponsored and promoted and built in Connecticut.

I happen to know because on a fateful weekend in September 1998, I was asked by then-Secretary Rubin to fly up there and sort of look at it a little bit with the New York Federal Reserve. I was at the U.S. Department of Treasury. This Connecticut hedge fund had a $1.2 trillion derivatives book. These days that sounds kind of small but it wasn't, and 1.2 trillion (dollars) can cause a lot of mess. And that book was going to go down and threaten some stability in the U.S. economy.

I remember the fateful phone call on a Sunday night to Secretary Rubin when I had to tell him it was going to go down, and he asked me what was going to happen. I said, frankly, Bob, I don't know, but one thing I did learn today is they book all their trades in their Cayman affiliate and we have no idea what is going to happen under Cayman law when this occurs. And last year, if I was just to add one more, JP Morgan and the issues that came up, though they ultimately didn't threaten the bank, they did take a $6 billion loss out of their branch in London.

So these global institutions – these global institutions are global, and they operate and need to operate around the globe, but ultimately I think Congress was aware about that and knew this painful history when the included the language in Dodd-Frank that the CFTC should consider the direct and significant connection or affect on U.S. commerce. How could we not say that Lehman Brothers, Citicorp, Bear Stearns, Long-Term Capital Management, JP Morgan and so forth and so on didn't have a direct and significant effect on U.S. commerce? But some of the banks would suggest otherwise.

The CFTC, in June of last year, proved an interpretive guidance on these critical 16 words. We were asked by the banks to do it. Congress didn't actually say we needed to interpret these 16 key words, but I think it was the right thing and I'm hopeful that we will actually finish this guidance on Friday.

At the time, the commission proposed a one-year transition period so around-the-globe institutions could phase in to the requirements. And we've been committed to phasing in requirements all along the way. Congress didn't mandate that we phase in requirements but they gave us great flexibility, and we thank Congress for it and we've used that flexibility three years after the law passed.

In December we finalized that transition period, but that transition period expires in two days. This is not the first date that things have expired. It's probably the 20th or 30th date that things expired. This one just has more attention. But we had a deadline that clearing started March 11th. We had a deadline that various reporting started December 31st and dealers had to register in December.

We've had a deadline just two weeks ago on July 1st that all of the back-office documents had to be entered into, called swap documentation. And believe it or not, 7,800 institutions actually adhered to new documents on July 1st through ISDA, which is the International Swaps and Derivatives Association – did a terrific job doing a protocol so that those institutions could adhere to new documents.

So to ensure that we don't undermine the critical steps of Dodd-Frank, the final guidance I believe needs to have at least the following. Let's see, how many do I list? Four things.

First, I think the requirements must cover swaps between U.S. swap dealers and guaranteed affiliates of U.S. persons, as well as swaps between two guaranteed affiliates. So basically if it's a U.S. person and you're guaranteeing the swaps business of your offshore affiliates, I think Congress clearly said that's got to come under it.

We're willing – and I think it's appropriate to say compliance of these requirements can come under comparable and comprehensive rules abroad, you know, where they exist, what we can call substantive compliance. There's 180 jurisdictions around the globe. Europe has made tremendous progress.

This has been a journey together with Europe. It's been a journey together with Japan, who's passed laws as well, but not every jurisdiction has passed laws like Congress did. The history in AIG and Lehman and Citi I think really dictate and mandate that we cover these guaranteed affiliates, even if it's covered by what we call substituted compliance.

Second, I think the definition of "U.S. person" must include offshore hedge funds and collective investment vehicles that have their principal place of business here in the U.S., like Long-Term Capital Management did.

That fateful phone call – I mean, could you imagine that Congress passed these commonsense reforms in Dodd-Frank and we've finished all of this, and then at the end of the day that it might not cover Long-Term Capital Management because they happen to jurisdictionally set up in the Caymans? Maybe they'll hold a board meeting down there once a quarter, but it's really here that the – the nerve center was in Connecticut. The operations was in Connecticut – the majority ownership and so forth.

If we don't, I think then all of the P.O. boxes will just go to some tropical island. And again, I'm not talking about, like, Europe. I'm talking about there's lots of jurisdictions that would love to just collect a few fees and have P.O. box registrations.

Third, foreign branches, like the foreign branch that was operating in the JP Morgan situation, have come to us and said, could we possibly get this thing called substituted compliance? Could we, though we are legally completely intertwined as the same person as the legal entity here – see, a branch is not a separate legal entity but they've come to us a year-and-a-half or so ago and said, could we possibly get some of that thing called substituted compliance?

And we put out in the proposal last July – and I believe it's still appropriate to include – that these dealers could possibly comply through substituted compliance. However, we have to have a really tight and appropriate definition that it's a bona fide branch that has the employees, the taxes, the accounting and so forth, the payments really offshore and it's really not just a couple of folks in New York saying, I'll book it in my branch, you book it in your branch and we'll avoid that thing called Dodd-Frank.

Fourth, swap dealers, foreign or the U.S., transacting with U.S. persons – whether it's here in the District of Columbia, whether it's in New York, New Jersey, Michigan, any state, my home state of Maryland; really I think it's straightforward – should comply with Dodd-Frank. That in fact is where we've been since December 31st. These 80 or so registered dealers have been making significant efforts to comply, and since December they've been reporting to the trade repositories, they've been reporting to the public with a bit of a time delay. They've been centrally clearing. And they now have their documentation and doing the sales practices.

The facts on the ground are actually very good. And any of you that worked on Dodd-Frank, you should be applauded and proud of your efforts because though it's taken us longer – Congress gave us one year to get the job done – this reform is actually coming to life, and the international dealers, whether they're from Europe or Asia, are actually complying when they're facing a U.S. person.

We're committing to work through any instances where the CFTC might be aware of conflicts with other jurisdictions. We have been on a journey with Europe that's probably well-reported in the press, and so I'm just anticipating a question that could come.

Michel Barnier and his whole – Michel Barnier is a commissioner for internal markets I think is his title, and competition at the European Commission – but we've been on a journey together with Europe these last four years. They've passed a law, as we have passed a law, and Japan has. They have put in place many of the same rules that we have. And where there are conflicts, where there are issues, we continue to work through them as well.

So to just summarize, some large financial institutions with swap businesses that dwarf the ones from 2008's crisis – AIG, by the way, only had a 2 (trillion dollars) to $3 trillion derivatives book, and it was a core group of about $80 billion of credit derivatives that really was the stinker in there – that's a technical term – (laughter) – would say, look, for competitive reasons, we don't think that Dodd-Frank's reform should extend to our affiliates around the globe.

And it's not that their perspective does not have some validity. I mean, there are competitive issues around the globe but I think Congress was trying to balance those competitive issues to how risks come back here. And we at the commission have also tried to balance it by saying, if it's offshore in one of those guaranteed affiliates and there's something there to rely upon – if it's comparable and consistent – that we'd like to rely on that home country and to manage some of those competitive issues. But if there's no “there” there, if there’s no comparable and consistent reforms in those other jurisdictions, then I think we will have left the American public without what they really need.

I’m just going to close with a little story about Baltimore and then take questions. My dad passed away last year. But he never went to college. Neither did my mom. And he started a little business with this $300 mustering out fee in 1945 when he came out of the war. His mom was a little upset that he did that, but over time he built a little business. He never had more than 30 employees. It was a vending business. And I remember weekends and summers working there all growing up. I’ll tell you, my dad, if he didn’t make payroll on Friday – and it was cash payroll in those days, but if he didn’t make payroll, nobody was going to bail him out.

I think that’s kind of the American way. And it’s a harsh reality of our economic system, but it’s what we all benefit from, that we don’t bail out banks or the little operator of a vending machine business in Baltimore. And I think at the core of Dodd-Frank is trying to end “too big to fail.” And I would say, if we don’t address this cross-border issue, then we really haven’t done what we need to do to address “too big to fail.” “Too big to fail” is about enough capital and the size of banks and a lot of other things. But derivatives were at the core of the ’08 crisis. And if we forget about the histories of the AIGs and Lehmans, Bear Sterns and long-term capital managements and so forth – if we forget about that history, we will also have, unfortunately, probably forgotten about the American public and left them in the lurch because you wouldn’t have solved “too big to fail.” Derivatives are a part of this as well.

So I thank you. I guess I’m supposed to take some questions, Jim, if you want me to.

MR. KESSLER: Yes, please.

MS. : Scott has the microphone over here.

MR. GENSLER: And I’m going to apologize in advance. There is some chance that John Reilly (sp) is going to wave at me and I'm going to have to take a phone call. But all right, you haven't done that yet, John (sp). Right. OK. Right.

Q: Earlier in your speech you talked about the back office –

MR. GENSLER: And if you could let me know where you're from.

Q: Sorry. Chris Robb from the Conference of State Bank Supervisors.

MR. GENSLER: Great, Chris.

Q: Thanks for coming today, sir. And you spoke about the back-office mess and how that can obviously exacerbate financial crises and obviously you're familiar with the paper crunch. Certainly there was a back-office mess in just mortgage loans, which I think really filtered down into the misevaluation of the derivatives that were based on their value. How successful can derivatives reform be?

And I think this also ties into Libor manipulation, if the underlying assets are still up – grossly misvalued, be it because of fraud of manipulation. In other words, if those underlying assets are misvalued and thus subject to rapid price swings, I mean, you're going to have massive derivative losses every time. How do we address that issue?

MR. GENSLER: So, Chris, there's a lot in what you just laid out, but derivatives derive their value from other things in our economy. Initially, it was on physical produce and production of the farmer, but it now derives value from even things like interest rates. And it's critical that the reference – the corn or wheat or interest rate or oil or mortgages – not be manipulated or the big derivatives markets can be.

And there's an interest rate that many of us in this room have actually had to pay or receive, you just didn't probably know it because it was in the boilerplate language in a student loan or the boilerplate language in your adjustable rate mortgage or car loan. And it's called the London Interbank Offer Rate.

And the London Interbank Offer Rate's existed for several decades, but what we at the CFTC, along with our friends over in London and the Justice Department here, brought three very significant actions where this rate was pervasively and readily rigged by Barclays, UBS and RBS, Royal Bank of Scotland, over numerous years and numerous offices by dozens of people with senior management knowledge in the banks, in fact in one bank all the way up to the executive management.

And we're working very closely with the Europeans and with the Federal Reserve here because Libor is not a good reference rate at this juncture. It's too prone to mischief – I'll use words that my mom would understand. And simply put, it's because the underlying market has dissipated or disappeared. Banks do not want to lend to each other on an unsecured basis as they once did. It kind of makes sense. I mean, why would they?

They're willing to lend overnight, but they're not really willing to lend out for three months and six months and things like that. So there's an international effort, chaired by Mark Carney, who's the new Central Bank governor of England and runs the Financial Stability Board, to really look at two key questions.

One is what's an alternative to Libor that's anchored in observable transaction? The key is in anchored in some observable transactions and good governance. And then two, how do we get there? Because you can have a really good reference rate but then there's a big transition issue as well.

MS. : So we – Scott has the microphone, so if you could just wait for him – (inaudible).

Q: Great. Hi, Kim Castle, Senator Feinstein's office.

MR. GENSLER: Hi, Kim.

Q: I was wondering –

MR. GENSLER: Please thank the Senator for me, because there's a lot of good things in Dodd-Frank from here.

Q: (Laughs.) I'll do that. I was wondering if CFTC had looked at all at entities or trades that don't have an explicit guarantee but, because of economic pressures to potentially back those when things go south, could bring risk to the United States.

MR. GENSLER: We have. And as I said, I'm hopeful that we'll get to final guidance Friday, but I don't want to get ahead of a commission process that's very active at this stage and ongoing. But Kim's question is basically, what if it's not explicitly, expressly guaranteed. I don't remember the language that we had in the proposal, but it doesn't have to use the word guarantee. If it's a guarantee or other forms of liquidity provisions around those swaps, that's what we're most definitely focused on.

I think we got a letter from – did your senator sign that one too? I thought so. So we've taken a very close look at that letter as a comment and, again, I don't want to get ahead of where we might come out on Friday, but I'm hopeful and we have read that letter very closely. I think I have to stop there because we're in an administrative process.

Q: I'm Daniel Himmel (sp) from the Joint Committee on Taxation. I know that the new central clearing requirements for credit default swaps only include a few highly liquid indices. And I'm wondering to what extent have you seen migration by market actors away from the indices that need to be centrally cleared toward substitute indices that may be largely overlapping but that wouldn't have to be centrally cleared under the CFTC regulations?

MR. GENSLER: You're raising an excellent question, to which I don't know the answer. Markets will and actors will, from time to time, find things that advantage them to get out of, you know, common-sense reform. But it's so recent – I can't remember; Sarah Josephson can remind me – but the credit derivative mandate phased in, but part of it didn't go in until April 28th, I think. So we're really just about two and a half months into that mandate.

But we did see – what we did see is a large financial institution sent a memo out to their clients on January 1st saying: Hedge funds don't need to clear until July 12th that are incorporated in the Caymans. They read through all of our releases and said, aha, what we think – we think, because the cross-border guidance hadn't been finished, as long as you meet us in London instead of meeting us in New York. And so we do want to close that. That seems that that – that's really – thwarts the intent and will of Congress, which brings me back to why we have to cover that.

So it's not directly to your question, but we are aware that there are many, many hedge funds that did come into clearing, but we're equally aware that there are probably as many that did not because they're booking their trades out of the – they're operated in New York or Connecticut or Chicago or New Jersey or elsewhere. Their principle place of business is here, but they're booking the trades from their Cayman entity to some bank in Europe or Asia. And that's one of the things we – I think we must and have to close.

I can hear you.

Q: Pearl Weyman (sp) with Congressman Keith Ellison from Minnesota. Thanks for your work and your leadership on this, especially over the last two and a half years. I think my boss definitely thinks it's time. On Friday he was one of the House members who sent a letter over saying that. I wondered if you could expand a bit on the harmony issue that we need to have. You talked a little bit about international harmony –

MR. GENSLER: And you're not – you're not talking about singing, because that's – I'm really bad at that.

Q: No, no – trying to get the 180 different countries on the same page just seems like an impossible task that slows everything down.

And then also the issue that's come up recently with the SEC and trying to have arrangements there, my understanding is that the vast majority of derivatives are regulated by the

CFTC, and only a minimal amount by the SEC, so if you can expand on that.

MR. GENSLER: Yeah, so I think we've made tremendous progress on this journey internationally; Europe, U.S., Japan and two of the big provinces in Canada have actually passed laws. Now, in terms of actually implementing those laws, the European Union, which is 28 nations, actually, the U.S. and Japan have actually done a fair amount of the implementation on central clearing, on reporting the trade repositories, on some of the risk mitigation.

Where we've seen less progress to date, at least, is on the public market transparency, and I think that our markets and our public will benefit greatly from that public market transparency. Europe is close, but they're not there, to finalizing legislation in something called MiFID, which I can't remember what those five letters stand for.

In terms of harmonization – I mean, there's not a day that doesn't go by that Sarah Josephson, who runs our international, or I am on the phone with our good friends and colleagues in Brussels, London, Tokyo, et cetera, et cetera, particularly Brussels, Paris and London. And a lot of our – a lot of our final rules are similar. We took to something that I don't know that any other federal agency did, but when the law passed, we sent all of our – if we sent a memo to our commission, the five-member commission, a term sheet or recommendations or a draft proposed rule, we sent it to the European Commission, as well. And the lawyers figured out how we could do that and not make it a public document.

But we've consistently got really good feedback from the European Commission and the European Central Bank and the financial services authority in London, and so forth. And we share all our documents with the SEC and the U.S. Department of Treasury and the Office of the Comptroller Currency (sic) and the Federal Reserve, I mean, all – and I'm not aware of any other agency in town that does that, by the way.

And we've gotten tremendous feedback. We don't always agree – (chuckles) – but the documents and the final results are far better getting that feedback.

The SEC and we have done tremendous together, Mary Jo White and I are getting to know each other, but even before that, Mary Schapiro and I – it just felt like it was the closest partnership that I had. And we wouldn't have this reform if the SEC and we hadn't jointly figured out what the definition of a swap dealer is or a swap. I mean, the SEC has been a terrific partner.

But you're right, because of how Congress has laid it out, something like 95 percent of the derivatives market has come under the jurisdiction of the CFTC. And though we're disadvantaged because we're a lot smaller than the SEC – we're only about 680 people and they're 4,000 – they've got a huge number of things that Congress has asked them to do, on the JOBS Act and Dodd-Frank and – they have hundreds of more things to do than we do. They bring seven times the number of enforcement cases than we do, and so forth. And it all has to go through one commission.

So I think it sort of makes sense that we would have taken the year that Congress gave us and in three years, basically finished the rule-writing, and we're well over half implemented, and that the SEC has got a lot of other things. And Congress wants the JOBS Act done and the money market fund reform, and so forth. So we're in a bit of a different timing place than the SEC.

And lastly, the statute is different. In the House Financial Services Committee, there was a debate about cross-border, and the CFTC working with Chairman Frank and Spencer Bachus – I mean, it was a bipartisan effort – and ultimately, with the House Agriculture Committee, but it was the House financial services – these 16 or 20 words came from the House Financial Services Committee. Those words are not on the SEC side. So there's this – there is a relevant statutory difference. I don't want to make too much of that, but we're being – we're interpreting 20 words that aren't over on the other side.

MR. KESSLER: Any other questions?

Q: Hi, Chairman Gensler, Adrienne from Senator Leahy's office.

MR. GESLER: Hi, Adrienne.

Q: You've talked, obviously, a lot about Dodd-Frank. We obviously have CFTC reauthorization. You mentioned the intent and will of Congress earlier. Are there things that you're hearing from groups or members here related to reauthorization that worry you or give you pause? Or are there areas that we should be more aware of that – where folks are getting it right?

MR. GENSLER: I'd like to have the opportunity to come back to you – (laughs) – because I've been so focused on cross-border, I think that it really is our hope and intention to finish this on Friday. I think that we've – have a tremendous flexibility that Congress has given us on phasing in compliance, and we've been doing that.

I do think, aside from the Dodd-Frank reforms, we need to finish the SFTC enhanced customer protection, I don't think we need necessarily Congress' help there, but we need to finish the customer protection rules, you know, post the events over the last two years at Peregrine and MF and so forth.

But I'd like to take the opportunity, if I can, to – maybe if we can get back to you and Senator Leahy on thoughts about reauthorization.

MR. KESSLER: I think we have time for one more question, if anybody –

Q: Jeff Siegel with Senate Banking Committee.

MR. GESLER: Hi, Jeff.

Q: Just – good to see you – two – just two general status questions – and I'm not sure exactly what you can say – but –

MR. GESLER: I'll give it my best. (Chuckles.)

Q: Could you just give, given the broad interest and the number of people here, could you give us an update on where things stand on your cross-border discussions over at the CFTC? What do you think – in the event that you cannot reach agreement on Friday, what happens on Friday? Is there some type of additional guidance or relief?

And also, you mentioned your discussions with Commissioner Barnier and the EU. How does that fit into what you're doing on the guidance on cross-border, from a process standpoint?
MR. GENSLER: So we've continued to make progress, active discussions at the commissions, and I'm focused and hopeful that we'll complete guidance. We have two documents in front of commissioners. One is finalized guidance that actually first went to commissioners in November, and then commissioner said, well, can we ask some further questions of the public. So we decided to ask those further questions. And then another version in final form went in May. And we've been working it and working it and working it since then.
We're a five-member commission. We generally find consensus. We don't always. But of the 56 final rules, if I can just say, there's only six that were split 3-2. Fully two-thirds were unanimous and another 20 or 25 percent were 4-1. So we really do make every effort we can to find that consensus. And I know Congress does too, but I'll hold our statistics up. (Laughter.)
But I – you know, I recognize, this one's a big one. This one's intense advocacy. Frankly, it's mostly down to these 16 large institutions around the globe. I don't mean that commercial end users don't have some interest in this issue, but – or the buy side, but this is now largely competitive issues between the commercial banks out of the U.S. and the investment – the traditional investment banks of the U.S. and how they

compare to others overseas. But I'm hopeful that we'll get there.

The two documents, one is final guidance, and secondly, phasing in compliance with this final guidance through the form of another exemptive order. We've always been committed, at the CFTC, of using public roundtables and other mechanisms to phase compliance. If we, for instance, have a definition of U.S. person that includes these offshore hedge funds, we give people some time to get – you know, for the hedge funds to get that new definition, to start ignoring that January 1st memo from Wall Street.

On Europe, again, we've made enormous progress over four years. So I don't just want to focus on the last three weeks. But we resolved some really important issues back in February with Europe. Sarah did this in a meeting in Bern, Switzerland, and then I was asked to play cleanup roll in a meeting in Boswell (ph) I guess a week or two later. And we put some things out on our website in April on those joint understandings.

But we've continued to work. It's been publicly reported. A bunch of us met in Montreal a few weeks ago. But even before that, I feel that Jonathan Faull and I have each other's numbers on speed dial and his home number and his mobile numbers. (Chuckles.) Jonathan Faull is Michel Barnier's executive director, I guess, for that whole unit in the commission. And I was – I was pleased to see that Michel earlier today – this is Commissioner Barnier – earlier today at a news conference in Europe said some very hopeful words and I share – I'm hopeful that we're able to resolve any remaining issues in the next day or so, day or two days. I guess it's two days, right? We've got two days?

But it's a journey. Even as we resolve things, I want to say this to all of you, this guidance that seems to have outsized, you know, news attention, or our discussions with Europe, are only part of continuing to adapt and be sensitive. As markets adjust, regulators always need to adjust as new facts come in. And what we have found on these 56 final rules is that when you get to an implementation day, when you get to a key December 31st or March this or July this, a bank or a commercial end user or a trading venue will come in and say, you know, I'm paid 72; footnote 88, it says such and such. Did you really mean it? Can we – can we talk about it some more? And for a small underfunded agency, I think we've done – you know, we've kept our doors completely open. And we need that input. We need, I think, to be an effective regulator, it's to show that flexibility of phasing in compliance, adapting to new issues and I think that will go on well past Friday if we finish this guidance.

MR. KESSLER: Mr. Chairman, thank you very, very much – (inaudible). (Applause.) Thank you for coming on what is obviously a very busy week. I want to thank the staff and the people who came here, especially the people in the rafters, for joining us. And our next paper coming out will be on money market mutual funds, which I think comes out this Friday?

MR. : Next Friday.

MR. KESSLER: Oh, next Friday. There's another big announcement on Friday. It's our money market mutual paper. So thank you very much again.

(END)

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