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MITIGATING SYSTEMIC RISK IN FINANCIAL MARKETS THROUGH WALL STREET REFORMS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING EFFORTS BY THE SEC AND CFTC TO IMPROVE FINANCIAL STABILITY AND REDUCE SYSTEMIC RISK IN THE FINANCIAL MARKETS THROUGH IMPLEMENTATION OF THE DODD-FRANK WALL STREET REFORM ACT AND THE CONSUMER PROTECTION ACT OF 2010

JULY 30, 2013

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C O N T E N T S

TUESDAY, JULY 30, 2013

MITIGATING SYSTEMIC RISK IN FINANCIAL MARKETS THROUGH WALL STREET REFORMS

TUESDAY, JULY 30, 2013

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:05 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good morning. I call this hearing to order.

Today we welcome Chair White and Chairman Gensler to update the Committee on important work underway at the SEC and CFTC to implement the Wall Street Reform Act and reduce systemic risk in our financial markets. We look forward to hearing about the progress being made to better oversee the derivatives market, finalize the Volcker rule, and implement changes to money market funds and credit rating agencies, among other reforms.

On derivatives, the SEC and CFTC should be proud of the progress made to date. Important rules governing clearing and swap data reporting have taken effect, with the majority of other rules slated to be completed and take effect in the months ahead. Also, due in no small part to the work of both agencies, the U.S. has provided the template for how other Nations should regulate derivatives. This large, global market demands strong, coordinated regulations to help improve financial stability, and I commend the recent CFTC agreement with the EU Commission to establish a framework that relies on strong cooperation between our two jurisdictions. As you work to harmonize international swap regulations, the SEC and CFTC should continue to harmonize your separate rules in a way that avoids market disruption or fragmentation.

On other reforms, the SEC has made progress to address areas of systemic risk by proposing rules to implement money market fund reform. The proposed rules follow earlier reform measures taken by the SEC, and I hope the considerable work that has been done in this area will result in a more stable framework for the money market fund market.

We also look forward to hearing more about the SEC's efforts to address flaws in the operation and use of credit ratings that were exposed by the financial crisis. As required by the Wall Street Reform Act, there has been extensive examination of this issue, and I look forward to improvements in the credit rating process.

Last, actions that improve investor protection will restore confidence in financial markets and bolster financial stability. To that end, I want to encourage the SEC and CFTC to continue to use every tool Congress gave them to stop fraud and protect investors. That is also why I believe the SEC should move forward with adding sensible safeguards in the private placement market.

With that, I look forward to hearing today's testimony, and I now turn to Ranking Member Crapo for his opening remarks.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman, and I agree with the concerns and issues that you have raised. Today we will hear from SEC Chair White and CFTC Chairman Gensler on their implementation of financial reform, including Dodd-Frank and the JOBS Act.

Having just passed Dodd-Frank's third anniversary, there is still considerable work to be done. Among other things, this hearing provides an opportunity to learn more about the steps they are taking to fix the lack of coordination and harmonization of rules among the United States and international regulators for the cross-border derivatives market.

The unique role that the securities, futures, and swaps markets each play has informed the manner in which the SEC and CFTC regulatory regimes have developed since the 1930s. Notwithstanding these differences, it is critical that the SEC and CFTC harmonize their regulatory approaches where sensible, both domestically and abroad.

True harmonization is not only getting on the same page, but it is working together to get on the right page. The U.S. markets are the most liquid in the world and must remain so.

Market participants must not be discouraged from entering a market that will allow them to allocate their risks, hedge their investments, and grow their business. The cumulative regulatory burdens that will flow from a regime that is not truly harmonized will work against the flow of free capital in the United States and abroad.

The CFTC has issued an array of interpretive guidance, exemptive orders, and no-action letters on cross-border issues. The CFTC's initial proposal for the cross-border implementation of Title VII received criticism both domestically and in foreign markets participants and regulators as being confusing, overexpansive, and harmful.

The final cross-border interpretive guidance announced by the CFTC on July 12th continues to raise questions both as to its substance and the process surrounding its issuance.

In the hours leading up to the CFTC's final guidance, the CFTC and European regulators issued a joint statement regarding how international coordination of rulemaking should proceed. This path forward has been characterized as an "agreement" when it appears to be a statement of future collaboration. While this development may prove to be constructive, a number of questions still remain.

For example, how will conflicts in rules for central clearinghouses, which will handle the large majority of trades and collateral posted by swap dealers, be addressed across borders?

We also need information as to what agreement has been reached, if any, regarding treatment of margin for end users.

Timelines for implementation remain very much in flux, and the path forward does not make mention of Canada or various Asian jurisdictions where swap dealing takes place and where regulatory reform is progressing.

I look forward to hearing Chairman Gensler's testimony on what exactly was agreed upon with respect to these and other issues. With these questions unanswered, it is clear there is a lot of work to be done on international harmonization.

The SEC proposed its own cross-border rule on May 1st. In light of the far-reaching significance of this rule, the SEC also reopened comment periods for many of its previously proposed security-based swap regulations. The public is now faced with two marginally similar plans from two agencies issued through very different processes—the CFTC through interpretive guidance and examinations, the SEC through notice and comment rulemaking.

For example, both cross-border schemes contemplate substituted compliance, which is intended to provide foreign market participants with a chance to continue to abide by their own country's requirements if those requirements are deemed comparable to U.S. requirements. The willingness of each agency to grant substituted compliance for foreign jurisdictions is questionable. The details matter.

I look forward to hearing the views of Chair White and Chairman Gensler on these issues of truly international significance. Our capital markets are the preferred destination in the world and cannot be tarnished by virtue of two regulators that appear to be going in different directions and not working effectively with each other and their international counterparts.

If the current lack of coordination persists, it would not be surprising to me to hear additional calls for merging the two agencies into a single regulator for the securities, futures, and swaps markets.

I appreciate, again, your holding this hearing, Mr. Chairman, and I look forward to hearing from our witnesses.

Chairman JOHNSON. Thank you, Senator Crapo.

Due to votes scheduled on the floor this morning, opening statements will be limited to the Chair and Ranking Member. The record will be open for the next 7 days for opening statements and any other materials Members would like to submit. Now I would like to introduce our witnesses.

The Honorable Mary Jo White is the Chair of the Securities and Exchange Commission. She was confirmed to this position in April 2013.

The Honorable Gary Gensler is the Chairman of the Commodity Futures Trading Commission. He was confirmed to this position in May of 2009.

Chair White, please begin your testimony.

STATEMENT OF MARY JO WHITE, CHAIR, SECURITIES AND EXCHANGE COMMISSION

Ms. WHITE. Thank you. Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for inviting me to testify on behalf of the Securities and Exchange Commission regarding the steps the agency has taken in an effort to reduce systemic risk in our capital markets. We recognize the importance of addressing systemic risk in a manner that preserves the strengths of our financial system and protects both investors and taxpayers alike.

There are many ways in which the Commission has sought to reduce the likelihood of systemic risk, many of which stem from our efforts to implement the various provisions of the Dodd-Frank Act. I will highlight several of these in my oral testimony. Other steps are described in my written testimony.

First, under Title VII of the Dodd-Frank Act, the Commission, along with the CFTC, has focused on creating a new oversight regime for the global, multi-trillion-dollar over-the-counter derivatives market. To put this regime in place, the Commission has proposed or adopted virtually every rule required under Title VII. It is a regime aimed directly at mitigating systemic risk in the financial markets.

In 2012, along with the CFTC, we adopted rules defining key products and entities. In addition, the SEC proposed important rules setting capital requirements for security-based swap dealers and describing how those dealers would have to collect margin collateral. In the event of a failure, these capital and margin rules are designed to help protect customers and counterparties and limit the impact on the capital markets and the broader economy.

Given the global nature of the derivatives market, the Commission also has been working with our regulatory counterparts abroad and the CFTC to coordinate our approach. In May, we issued a proposal outlining which regulatory requirements would apply when a security-based swap transaction occurs in part within and in part outside the United States. Comments are due on August 21st.

Second, the Commission has been serving as the primary supervisory agency for four of the eight financial market utilities designated as systemically important by the Financial Stability Oversight Council. Under Title VIII of the Dodd-Frank Act, FSOC is authorized to make such a designation if the failure or disruption of the financial market utility could increase the risk of significant liquidity or credit problems spreading among financial institutions or markets. The SEC examines each of these utilities annually and reviews all proposals that affect the level and nature of risk of these entities in light of their systemic importance.

Third, the Commission adopted rules last year requiring registered clearing agencies to meet comprehensive standards with respect to risk management and operations. The requirements are designed in part to strengthen and promote consistency in the regulation of clearing organizations, thereby reducing systemic risk in the financial markets.

A fourth step we have taken under Title IV of Dodd-Frank is to establish reporting requirements for investor advisers to private funds on the new Form PF. The information submitted is intended in part to assist the FSOC in better assessing systemic risk across the market. The filing requirements for Form PF are scaled to the size of the adviser.

Last week, the SEC filed its first annual report to Congress relating to the use of the data collected. In addition, under Title I of Dodd-Frank, as the Chair of the Commission, I serve as a voting member of FSOC. Among other things, FSOC considers whether certain nonbank financial companies should be deemed "systemically important" and thereby subject to heightened prudential supervision by the Federal Reserve Board.

The Commission has also taken additional steps intended to further reduce systemic risk in the operation of our capital markets. For example, in March of this year, the Commission proposed Regulation SCI, which stands for systems, compliance, and integrity. Regulation SCI requires exchanges and clearing agencies to maintain policies and procedures reasonably designed to meet certain technology standards, and it would require appropriate corrective action if problems occur.

The Commission also approved a "limit up–limit down" mechanism that will create speed bumps to reduce abrupt market movements in individual securities, and put in place new marketwide circuit breakers to provide for brief, coordinated, cross-market trading halts during sharp declines in the securities market.

As a final example of the agency's work to reduce systemic risk, in June the Commission proposed reforms designed to reduce the susceptibility of money market funds to heavy redemptions so as to mitigate potential contagion effects and to increase the transparency of the funds' risks. Comments are due September 17th, and we look forward to public input on all aspects of this proposal, including whether the proposal appropriately addresses systemic risk concerns while maintaining money market funds as a viable investment product.

The men and women of the SEC have been tasked with expanded responsibilities to help mitigate systemic risk in the financial markets. I am proud of what they have accomplished, and I am confident that we will be able to also complete the remaining tasks before us.

Thank you very much. I would be happy to answer any of your questions.

Chairman JOHNSON. Thank you.

Chairman Gensler.

STATEMENT OF GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

Mr. GENSLER. Good morning, Chairman Johnson, Ranking Member Crapo, and Members of the Committee.

Today's hearing comes as market participants are well along a path implementing the congressionally mandated swaps market reforms, and the CFTC has nearly completed rule writing to implement these critical reforms. I am pleased to testify along with SEC Chair Mary Jo White—the second time we are testifying together in her now 3 months of tenure. But I am also pleased to say the CFTC has benefited greatly from the SEC's input and collaboration. On every step of this journey to bring about swaps market and securities swaps market reform.

Just as we have commonsense rules on our roads—by that, I mean traffic lights, stop signs, speed limits, and, yes, cops on the streets to enforce the rules—the comprehensive swaps market reforms that are nearly complete include complementary, robust rules of the road to benefit both those who trade swaps—those on the roads—and also those who do not, the bystanders in our society. Americans would never accept a city or highway system with no rules, no street lights, no traffic lights, or no cops.

Middle-class Americans paid the price of the financial crisis with their jobs, their pensions, and their homes. They were the bystanders that were not even standing on these complex roads called "derivatives." The crisis cost 8 million jobs and thousands of businesses, and the swaps market was right at the center of it.

And now the American public no longer will need to accept a dark market, that is, the swaps market, lacking commonsense rules of the road. That is because based on what Congress put in place and our completed rules, reforms now shine light on a marketplace that has been opaque for too long. Both the public and regulators have already benefited from what is called "real-time reporting." This started last December. It has been phasing in. There are some additional phasing dates in August and September, but for over 9 months, that full data set, regulators, like the SEC, like the Federal Reserve, and we have had access to it, and foreign regulators as well. Further, markets will shortly benefit from something called "swap execution facilities," a new trading facility that will bring greater competition, access, and pretrade transparency along the way.

Completed reforms also mitigate risk and broaden market access through something called "central clearing," a key part of the G20 commitment that the President laid out in Pittsburgh in September of 2009. The vast majority of interest rate swaps and credit index swaps are already coming into central clearing, but, again, key compliance dates go along the way through October of this year—October 9th will be an important date for some of the cross-border swaps to come into clearing.

Nonfinancial end users, as Congress dictated, will have a choice on central clearing, and consistent with this intent, the CFTC has proposed that margin for uncleared swaps will not have to be collected from such end users. To anticipate a question, we have been actively encouraging the international community to adopt that same approach. I believe in August we will publish international standards that will be consistent with that approach.

Third, completed reforms bring oversight to swap dealers. We now have 80 that are registered. Many of these were at the center of the bailout 5 years ago, and they are coming under business conduct and reporting rules. Completed cross-border guidance ensures that the far-flung operations of U.S. financial institutions will be covered by reform, either directly under Dodd-Frank or through what we call substituted compliance. That means if there is a guaranteed affiliate sitting offshore in a jurisdiction that does not have reform, then it is Dodd-Frank, if it is somewhere where they do have reform, we might look to those home country rules.

It is critical to the American public, and I am sure in South Dakota, Idaho, Massachusetts, and in Ohio, your publics are all saying, "Do not forget the lessons of AIG and Lehman Brothers and these other institutions that brought their far-flung operations risk back home."

We worked closely with international regulators, collaborated here and abroad, and most recently we came to these understandings with the European Union on cross-border transactions. To anticipate the question, many of these were included specifically in the guidance or were acted upon that day by no-action letters. I view those as agreements because they are embedded in Commission actions today. But there are some aspirational things that we still need to work on. This journey is not complete, and it is a multiyear journey with Europe and with Asia.

We do have work to do moving forward. Most importantly, we are working with market participants to smooth the transition to these new reforms. We do also want to work closely with the international community on the substituted compliance determinations. Last, there are a handful of rules, including capital, margin, the Volcker rule, and relooking at the position limits that need further work. But I thank you, and I look forward to your questions.

Chairman JOHNSON. Thank you.

Votes have just been called on the Senate floor, so we will take a short recess to allow Senators to vote. I ask the Senators to vote quickly and then return immediately to the hearing room so that we may resume questioning.

The Committee stands in recess.

[Recess.]

Chairman JOHNSON. The hearing will now return to order, and we will now resume the questioning of our witnesses. As we begin questions, I will ask the clerk to put 5 minutes on the clock for each Member.

Chair White, while I recognize there is a lot on the SEC's plate and Congress must do its part to appropriately fund your agency, how soon can we expect Wall Street reform rules to be completed, especially on derivatives, the Volcker rule, and QRM? What, if any, barriers are there to completing these rules?

Ms. WHITE. I share the concern for—and I think I testified in my confirmation hearing that one of my highest immediate priorities, is to complete the congressionally rulemakings under Dodd-Frank and the JOBS Act. I think we have made very good progress. We are continuing to push extremely hard to complete those rulemakings.

I cannot give you a precise timetable as to the completion for all of them, but I think you will see through the summer and through the fall and throughout this year those rulemakings coming out. That is my expectation and hope. I am not saying every single one will be done by year end.

In terms of derivatives, as I think I mentioned in my testimony, our comment period on the cross-border proposal ends on August 21st. We did reopen, as Ranking Member Crapo said, our substantive rules that we proposed in the derivatives space. That comment period ended July 22nd.

So it is my—obviously, I operate in a commission, but it is my hope and expectation that we will move into the adoption phase when those comment periods are completed.

QRM is one that is a joint rulemaking, as you know. We are working quite hard and quite actively now with our fellow regulators on that, at both the staff level and the Commission level. So, you know, it is, again, a hope and expectation that some action should be taken in the very near term.

On Volcker, I think particularly in the last 2 or 3 months, obviously an extraordinarily complex rulemaking. We need to get it right to make sure we are carrying out the statutory objectives. But we also want to make sure that we are dealing with the exemptions that occur so that we do not have unintended consequences there.

We are working quite well in the last 2 or 3 months particularly with our fellow regulators on that. I think Governor Tarullo may have testified before this Committee, maybe more than once, that his at least hope and expectation is that may be completed by year end. I hope that is correct.

Chairman JOHNSON. What, if any, barriers are there to completing these rules?

Ms. WHITE. I think what I would say the barriers are, the SEC was given, depending on how you count it, over 90—and this is under Dodd-Frank, alone—92, I think, and if you count subsets, about 130 rulemakings under Dodd-Frank. So there is a lot of volume. Many of them have a great deal of complexity. Some of them are done, as they should be, jointly with other regulators. I think those would be the factors that I would point to, and there has been, no question about it, some backlog at the SEC.

When I arrived there, I tried to make certain that we had parallel work streams working on both the Dodd-Frank rulemakings and the JOBS Act rulemakings so that we did not have the same people at the staff level working on different rulemakings. So I am hoping to expedite and complete that process.

Chairman JOHNSON. Chairman Gensler, consistent with the CFTC goal to limit regulatory arbitrage, will the CFTC allow swap trades between non-U.S. customers and foreign branches of U.S. swap dealers to rely on substituted compliance? In comparison, how will the CFTC treat swap trades between non-U.S. customers and foreign affiliates of U.S. swap dealers?

Mr. GENSLER. I am pleased to say that we were able to finalize guidance with a lot of public input, and this issue was one of those, where the overseas branches and overseas guaranteed affiliates of U.S. swap dealers are covered by reform. This is necessary because so much of that risk did come back in 2008.

Specific to your question, if a branch of a U.S. swap dealer is dealing overseas, it is part of the U.S. person; it is part of the legal entity. And we would look to substituted compliance if there are such rules in place.

We did have a carveout, though, that said that up to 5 percent of their business is in emerging markets, that they might not have to come in.

For the guaranteed affiliates, if it is truly an offshore entity operating in London or Toronto or Tokyo and doing a business with some local insurance company, the transaction level compliance, we said that is up to the foreign jurisdiction, not ours. Sort of similar to this 5-percent exception for the branches.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman, and both Chair White and Chairman Gensler, in my opening statement I mentioned that there are some discrepancies between the rules and guidances that the two agencies are engaged in, both in terms of the substance of how they are being adopted and in terms of their actual substance. And my question to both of you is: Do you agree that we need to have as much coordination on these rules and guidances as possible so that both agencies are, to the maximum extent reasonably possible, on the same page and on the right page? And if you agree with that, are you undertaking actions to coordinate and communicate with each other to achieve these objectives? Chair White.

Ms. WHITE. I do agree with your statement, Senator Crapo, very much so. There may be some differences because we have different markets, different market participants, but for the most part, I think we need to strive for consistency, avoiding disruption, avoiding duplication.

The staffs of the agencies have been, before my arrival and after my arrival, working together with each other sharing drafts and having discussions. Obviously differences do remain. One of the things you will see in our proposal where the comment period ends in August is we specifically tee up that consistency question. And what I would like to see going forward—there are open issues to deal with—is even an increase in the depth of engagement at the principal level as well as the staff level.

Senator CRAPO. Thank you.

Chairman Gensler.

Mr. GENSLER. Senator, I do agree. We have been coordinating and collaborating all the way back to the legislative phase and to sharing our term sheets. If we send a term sheet or a draft memo to our Commissioners, we send it to the SEC. We also share with the Federal Reserve and other U.S. regulators, and internationally as well. We have gotten tremendous feedback. We do have some differences, of course, because this is the only thing we focus on—futures, commodities, and swaps—and the SEC, frankly, has so many other things. We oversee markets called the "interest rate swap markets" and some other markets that are so large that they are well over 90 percent of the swaps markets.

Last, there are some small but very important differences in the law themselves, a swap, for instance, is not a future, a securities-based swap is a security. This was embedded in the laws. It might sound like a small difference, but actually the lawyers tell me it is a big difference. Also on cross-border, Congress expressly had direction for the CFTC that was not included in the SEC. You may have heard these words, but it is about a direct and significant connection to or effect on U.S. commerce or activities. If I have the words garbled, I apologize. That is what we were asked to give some guidance on and did so.

Senator CRAPO. Well, I appreciate your answers and encourage you to continue to try to coordinate to the maximum extent reasonably possible.

Chairman Gensler, a number of questions remain regarding the path forward, and in my introductory comments I indicated I thought it was more of an agreement to agree or to collaborate further. But I think in your opening statement you indicated you felt there was more specificity than I was suggesting. Could you just explain that a little better and what you believe the next steps are to implementing the path forward?

Mr. GENSLER. Why, thank you. We have worked really on this journey for 4-plus years with the European Commission and the various European authorities, and we decided to put in writing this 10 or 15 pages about a path forward that I thank you for highlighting.

Many of those pieces were incorporated specifically and expressly in the Commission guidance, particularly about when international parties meet on trading platforms. It is in our guidance. We expressly said that a U.S. person could fulfill some of their trading requirements under Dodd-Frank even on foreign boards of trade, so they do not have to do it here in the U.S. on swap execution facilities. That, too, is expressly in the guidance that is—everybody can use that.

We took most of that path forward, wherever we could, and we put it in the guidance or in addition in some things called "no-action letters." Going forward, though, we will be working with Europe, Japan, Canada, Australia, Hong Kong, and Switzerland on looking at whether they have comparable rules overseas, and where we can, particularly on the entity-level requirements, we hope to do some substituted compliance determinations before December; and where we cannot, at least alert market participants to that.

Senator CRAPO. Thank you.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. Thank you both for your testimony.

Chair White, let me ask you, there is a comment period going on now with the SEC as it relates to proposed money market fund rules, and I am sure you are already receiving a lot of responses to that. Money market funds remain an important financing channel for investors, fund managers, for companies and local governments who obtain financing through money market funds. And they have expressed concerns that one of the SEC's proposals about floating a net asset value could potentially cause some investors to turn away from money market funds and thereby increase funding costs for borrowers.

For example, the U.S. Conference of Mayors, an organization I work with quite closely, having been a former mayor, recently adopted resolutions—which, Mr. Chairman, I ask consent to submit for the record.

Chairman JOHNSON. Without objection.

Senator MENENDEZ. They recently adopted resolutions where they talk about these concerns, and I think, if I am not mistaken, it was the SEC itself that in one of its studies said that the floating net asset value does not in and of itself solve the concern of solvency issues, might make it, you know, more understanding of what the potential exists in the marketplace. There are those who suggest that gating is more likely to create a safeguard.

Are you going to be considering the consequences in the marketplace—I know you are not ready to determine here at this moment on the rule, but are you going to be considering as part of the equation what happens in the marketplace, what happens to access, to, for example, public entities like municipalities across the Nation, as well as other entities in terms of making this decision on what the rule should look like?

Ms. WHITE. No question about that, Senator. We obviously did that kind of analysis, aided by our economists, when we made the proposals we did. There are actually alternative proposals, one that proposes a floating NAV for prime institutional funds only, not for Government funds or retail funds, and another that is a fees and gates proposal. We also invited comments on combining them. But we are very interested in the impacts under both proposals, taken separately or combined, and will be studying all of those comments very carefully.

Senator MENENDEZ. I appreciate that. I have a feeling that there is some suggestion or some pressure that exists out there, at least from my perception, that the Fed wants to see this happen. You have the jurisdiction here, and having a merger for the sake of making everybody happy over these two rules is not—these two elements of the rules, the two options, is not the optimum result. So I hope you will look at the real consequences in the marketplace and making sure that what you ultimately do is to ensure the very safety and soundness of those funds versus just responding to another entity that may have their own views.

Ms. WHITE. If I may, Senator, this is a space where the SEC has the expertise. The SEC has acted. Obviously we take input from wherever it comes from that is useful, whether it is fellow regulators or the public or end users. But it is something we will decide quite independently.

Senator MENENDEZ. During your confirmation hearing, I asked you on a provision that I included in Dodd-Frank, which was the issue of having disclosure in annual SEC filings of the amount of CEO pay to the amount of the median company worker pay and the ratio of the two. I asked you to look at that as the Chairperson. There was a Bloomberg report that suggested that the SEC is moving forward with a proposed rule soon. Is that a correct report, or is that an incorrect report?

Ms. WHITE. I would not want to comment on specific timing. I know the report that you are referring to. But we are very much as a staff and Commission focused on that rulemaking.

Senator MENENDEZ. OK. So while you do not want to commit to a time, since I have been waiting for several years now—which precedes you, but heavy is the head that wears the crown. Right now you have it. Can you give me some time frame here?

Ms. WHITE. It should be in the near future. I do not know if that is helpful to you or not. We have two new Commissioners.

Senator MENENDEZ. How do you define "near future"? Two months? Three months? Six months? A year?

Ms. WHITE. I would hope that it is completed in the next month or two. You know, we have two new Commissioners coming on board, or we are expecting to, so that may affect some of the projected timetables you may have read about.

Senator MENENDEZ. All right. Thank you very much, Mr. Chairman.

Chairman JOHNSON. Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman, and thank you and welcome to our witnesses today.

Madam Chairman, I just want to follow up—well, let me go to the question of the rules implementing some of the JOBS Act. I have got to confess, I continue to be frustrated. It has been over a year now. Reg A in particular strikes me as a relatively straightforward, relatively simple change in law that has been on the books now for over a year, and we still do not have a rule.

What kind of progress are we making? And what can we expect there?

Ms. WHITE. I think we are making progress. I think, Senator, you and I discussed this actually at my confirmation hearing, too. I think I commented that, from the outside at least, it would seem to me that with Reg A Plus, as we refer to it, the regulation should be one that could be done comparatively faster than others.

One of the reasons it is taking longer, although it is very much front and center with the staff and the Commission, is to make sure that it is workable. Reg A itself has not been used, particularly in recent years.

One of the issues that we are focused on—there was not sweeping preemption given to that rule—is to make sure that it actually is used once we adopt the final rules. But it is very much—I have several things on front burners, but it very much is one of those.

Senator TOOMEY. So it is on the front burner.

Ms. WHITE. Along with several others, but, yes, sir.

Senator TOOMEY. OK. Now, I know how reluctant you are to put a time frame on this, but I have got to ask you: Do front-burner things get taken care of this summer? Is that a fall kind of thing? When do you think we can——

Ms. WHITE. Well, again, I would just comment, I am one member of a Commission. I have two new Commissioners coming on board. But I would hope we would certainly reach that by the fall.

Senator TOOMEY. OK. All right. Thank you.

Then I would like to follow up on some questions that Senator Menendez raised. Could you just briefly summarize what you see as the advantages of the disclosure mandate on floating NAV, the daily disclosure of a net asset value with greater precision, which is one of the proposals, as I understand it, for the nonprime institutional money funds?

Ms. WHITE. We certainly have in the proposal enhanced disclosures fairly across the board, and as you know, a number of prime funds have actually voluntarily made disclosure. What I guess now is referred to as the "shadow NAV." I think the floating NAV alternative that is the subject of a proposal would obviously have those disclosure features with it, but also would actually, change to a market value.

Senator TOOMEY. So I guess the question is: The argument that I most frequently heard advocating for a floating NAV was to provide additional, more precise information to investors. To the extent that that is provided, why is it necessary to operationally float the NAV? And, second—well, second, I would like to discuss the tax implications, but in the first instance, why is it necessary to operationally do so when the information is being provided?

Ms. WHITE. Again, those are among the questions that we have, I think, teed up, with the proposal. But disclosure itself does not change the transaction value. What this proposal would add to disclosure is that you basically would be transacting at a market rate. Simply knowing what the NAV is does not deal necessarily with the gaming of the one dollar price. And so the main thrust of additional money market reform is to deal with what is perceived to be—and obviously we had our economists study this—the run risk or the possibility of the run risk. And so it is not just a disclosure proposal, although that is included.

Senator TOOMEY. It seems to me that there is always a first-mover advantage regardless of whether you disclose a net asset value or whether you operationally impose it. It seems to me the main argument has always been about transparency and greater disclosure, and that is achieved by simply disclosure.

As you know, of course, there is a tax consequence if these minute changes manifest themselves in capital gains and losses that have to be monitored.

Clearly the SEC has no authority to make that problem go away or solve that problem, right?

Ms. WHITE. That is correct. We have been working closely with Treasury and the IRS on those issues. One is whether the wash sales rules would be, in effect, a problem if, in fact, the floating NAV proposal was adopted. And the IRS on that tax aspect has actually recently put out tentative guidance saying that you would not have that negative tax consequence.

There is another outstanding tax issue which we have not—the IRS has not concluded on, which is sometimes referred to as a "record keeping requirement," but it really would allow netting, which obviously would be very important to this proposal.

Senator TOOMEY. I am concerned that the operational challenges and potential remaining tax consequences of this would create a huge disincentive for firms, for institutions to use this very valuable tool, and I hope you will keep that in mind as you consider finalizing the rule.

Ms. WHITE. We certainly will, Senator. We also—and I think I have stated it publicly—are concerned about preserving the viability of the product.

Senator TOOMEY. All right. Thank you.

Chairman JOHNSON. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Mr. Gensler, manufacturers, as you know, that rely on aluminum to produce products—beer and soda pop cans and cars and other things—say that banks are using their metal warehouses to delay aluminum deliveries, driving up the cost of aluminum. These warehouses are linked to the London Metal Exchange. Apparently U.S. and U.K. authorities have said that neither has oversight over these bank-owned warehouses.

There is a 2000 Memorandum of Understanding with U.K. market regulators that entitles the CFTC to information regarding "the operations and stocks of warehouses," and "the use of warehouses by regulated market members, their licensees, or customers," including warehouses outside the U.S.

There is a 2001 no-action letter between the CFTC and the London Metal Exchange, conditioned in part on the fact that "the law, systems, rules, compliance mechanisms of the U.K. applicable to the London Metal Exchange will continue to require LME to maintain fair and orderly markets, prohibit fraud, abuse, and market manipulation." It appears that this is manipulation, at the very least abuse.

One of the purposes of the Commodity Exchange Act is to deter and prevent price manipulation or any other disruptions of market integrity.

Now, I understand from news reports that the CFTC has sent out notices to at least a couple of banks saying, "Do not destroy any emails," suggesting there will be an investigation.

So my question is: Does the CFTC have the legal authority to interrogate and investigate and address potential market manipulation occurring at U.S. warehouses that are harming U.S. companies? If not, how can that be?

Mr. GENSLER. Senator, we are a market regulator overseeing the commodity futures swaps markets and have clear authority to police these markets for fraud, manipulation, and other abuses, and we will use those authorities appropriately where we see abuses and pursue it. That is in the physical commodity markets as well as the derivative marketplace. We tend to do that when it is related to derivatives, but the authorities are there.

We also have authorities and Dodd-Frank included authorities with regard to something called "foreign boards of trade," and the LME is actually operating under, as you said, this no-action letter from 12 years ago, has followed along with I think 18 others to become registered foreign boards of trade. So we have that in front of us as well.

But, yes, we have authorities to pursue fraud manipulation and other abuses in the commodity markets.

Senator BROWN. So can you tell us what the next step is after you sent this admonition to these banks?

Mr. GENSLER. I think it would be best not to try to prejudice any matter that we might be—or might not be looking at. I think it would be better not to try to prejudice anything that we might be doing.

Senator BROWN. OK. This is a question for both Ms. White and Mr. Gensler. We know, as we heard in a hearing in my Subcommittee last week, that some banks own oil tankers and trade oil futures; others own energy transmission rights and sell energy derivatives; financial institutions in some cases control fleets of oil tankers and can withhold delivery while also wagering on the price of oil, or they can speculate on the price of energy while controlling its supply, as we saw in today's settlement between FERC and JPMorgan.

In a Reuters story, a commodities expert in 2012 said that owning physical assets while trading in financial markets gives you the visibility of the market to make far more successful proprietary trading decisions in both physical and financial markets. It is trading with material nonpublic information. The only difference, this writer pointers out, that this market experts points out, the difference compared with equity markets is that it is perfectly legal.

That certainly suggests a conflict of interest. Should the rules—and that suggests the question to both of you. Should the rules for commodities markets be updated to prohibit trading on this kind of, call it "insider," but at least two judging it, calling it "non-market information." Should these rules be updated? Ms. White, if you would answer that, and then Mr. Gensler.

Ms. WHITE. It is a subject matter that once it came to my attention—and that is fairly recently—I have actually asked the staff to examine that question, those series of questions. I cannot really respond further at this point other than I am looking into that and, frankly, the range of possible disclosure issues that could be involved as well.

Senator BROWN. Mr. Gensler.

Mr. GENSLER. Based on the Dodd-Frank reforms, we actually did update our whole regime about fraud and manipulation rules, and those were finalized about 2 years ago, and Congress expressly focused on information and deceptive practices.

As it relates to an individual having information, the commodity markets have been looked at. A grain elevator operator or farmer or rancher may know something about their crop and want to hedge that, and we would not want to diminish the ability of that farmer, rancher, or grain elevator operator to hedge that risk even though in a sense they might be the only one to know that their crop is not yielding as well as they thought or yielding better than they thought.

So there are some differences, but the good news is that Dodd-Frank did include and we finalized rules that give us a lot of enhanced protection. But, there is a long history of allowing the hedgers to really ensure that they can hedge their risk and not concern themselves that they might know something about their crop or what is happening on the ground that somebody else did not know.

Senator BROWN. Thank you.

Chairman JOHNSON. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman, and I thank the witnesses as well. And while I have not followed the issue as closely as Senator Brown, I think I would simply say, Mr. Gensler, that there is knowledge in the field on appropriate hedging, but some of the representations that Senator Brown made seem to be closer to manipulation than hedging. So I appreciate the work he is doing.

I want to come back actually, Chairman White, to my favorite topic, which is the JOBS Act, again, the crowdfunding issue. I think it is—I know Senator Merkley worked on this issue as well. I think there is enormous, enormous opportunity to use this new tool for equity crowdfunding that can really marry together in a remarkable way, particularly from markets, rural markets, smaller markets that do not have access to this early stage capital, this really could be transformative. I have traveled around Virginia and around the country, and there is a nascent industry waiting for the regulations to get out, and let me acknowledge on the front end the nature of this will be—I do not think the SEC will get it perfect the first time out, and there will be people who will lose money. But I do think there will be the ability for the Internet to kind of self-police a bit and call out bad actors in an appropriate way and to work with you I think is, again, different than the analogy that was sometimes made back to the old telephone boiler room operations where there was a lot of fraud.

So I am not sure you are going to give me the answer I am looking for, but back to the Senator Toomey analogy, I am hoping you are going to say this is front burner as well since it has been more than a year-plus, and we are seeing other Nations around the world move into this space and take away any potential first-mover advantage America has. How front-burner issue within the parameters of what you have been able to say, what else can you—a lot of folks are waiting for you to get these regulations out.

Ms. WHITE. I appreciate that, Senator, and I think there still is, despite the length of time, a great deal of excitement out there about this.

Again, I seem to be describing multiple front burners to some degree, but it is certainly—the crowdfunding rulemaking is certainly on one of those front burners. It has been quite an undertaking to some degree, although the crowdfunding legislation does build in a number of investor protections. Obviously the funding portals, there are some issues there. We are working very closely with FINRA to make sure that does not delay us, that we——

Senator WARNER. Right. Because once you are done, there is still a FINRA process as well.

Ms. WHITE. We are trying to land that at the same time, if we can, so that does not build in other delays any more than it needs to. So it is among those front-burner rulemakings very much in——

Senator WARNER. Summer front burner? Fall front burner?

Ms. WHITE. We are almost out of summer, right? We are almost out of summer. Yes, I guess I have defined "front burner" so far to be into the fall, but I do not want to really—again, what I have said before is, I really have separated out these work streams. I have prioritized as many as I possibly can, and I get them done as they are ready to get done. But it does not take away from what I said that it is certainly among those very front burners.

Senator WARNER. I would acknowledge that this is, you know, a new space, but I would simply make the editorial comment that this is one where the perfect could be the enemy of the good, and, you know, I think there will be mistakes made. I think all of us who supported the JOBS Act recognize that there were challenges in this space. But the potential upside in terms of connecting capital to entrepreneurs that otherwise are not going to exist—I was in Richmond yesterday where Kiva, which is the microlending site I know you are familiar with—launched in Richmond, and, you know, the lending portal is a little better, you know, less regulatory burdensome than the equity portal, although the Kiva fellows announced the fact that they spent about 7 or 8 years being told everything they were doing was virtually illegal. They have now done close to 900,000 loans and $500 million of lending with a rate of return north of 98 percent. So, you know, it is a pretty good system that actually both abroad and now domestically provides a lot of value. So my hope will be, again, that we keep this front burner.

I am going to run out of time here. I would simply—I wanted to get your comment as well on the swap depository—the swap data repositories, you know, these SDRs, and how you are working with—whether you are going to have to kind of reduplicate what your colleague Mr. Gensler has already done. We need to get these registered as quickly as possible. This is going to be an important part of transparency in the swaps market.

Ms. WHITE. I think just briefly on that, the SEC has actually put out what we call the "implementation policy," and those rulemakings are, I think, in our second category. I think the first category is to make sure that we get the cross-border out and adopted. Obviously mandatory clearing decisions have to be made, but I would not anticipate delay once we are at that stage.

Senator WARNER. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and thank you both for being here today.

Ms. White, one of the issues that we have talked about over the past has been the definition of a "fiduciary," and it is coming—obviously it is here again, this definition.

Now that you have had a few months in office, can you provide an update on the coordination between the SEC and the Department of Labor on this issue of the definition of "fiduciary" and how you are working.

Ms. WHITE. Yes. Obviously, again, we are independent agencies, but, I fully take all the points in that space about the desirability for consistency.

One of the things that we have done—and I think we did talk about this before at my confirmation hearing, again, before my arrival—the SEC staff has been working very closely with the Department of Labor's staff to make certain that they understand the broker-dealer business model impacts of rulemaking on those models. Obviously, we, in terms of considering a fiduciary duty standard, are also told other things about what we can do and not do. The commission structure remains, principal trading remains.

What I have done, I think July 5 was when our period of comment closed on our request for additional information on the fiduciary duty, so that is fairly recently closed. I have actually personally met with senior officials at the Department of Labor and directed the staff to really engage even more actively than they have in the past to try to coordinate, try to make certain that the Department of Labor understands our perspective and we can provide our expertise.

Again, we have our different rules, are different agencies, but that is really the status.

Senator HAGAN. I appreciate you taking that effort. I appreciate that.

On the asset management study, as you know, the FSOC is responsible for the designation of systemically important nonbank institutions. The FSOC has indicated publicly that it is reviewing what risk, if any, the asset managers pose to the U.S. financial system. The SEC is the expert agency on asset management, both from its long-established oversight of the mutual fund industry, but also more recently with the Dodd-Frank requirement that advisers to private funds, such as private equity and hedge funds, register with the SEC as investment advisers.

My question is: What role is the SEC playing in this FSOC review? And is the SEC being active here? And if so, is your expertise being reflected in the study?

Ms. WHITE. The answer is we are very active. The study is actually with the Office of Financial Research, but my staff is extremely active in providing comments, again, providing expertise in connection with that study. I cannot tell you when it will be completed, but we are quite active in participating in that process. Again, it is not being led by us—but, certainly we are being listened to, and we are very focused on making certain that that level of activity and interface continues.

Senator HAGAN. One other question back on the definition of "fiduciary," and you mentioned that July 5th was the end of the comment period. What do you see as the time frame going forward on either the SEC and the DOL setting the actual definitions?

Ms. WHITE. I cannot speak for the DOL——

Senator HAGAN. I did not know if you had heard any comments through that.

Ms. WHITE. I think that they are considering kind of what to do next. I mean, what we are focused on as far as they are concerned is just making sure they have all the expertise and data.

In terms of, a timetable for what we may do at the SEC, that is something we are focused on, but we obviously have a very full plate of mandated rulemakings as well. But it is not—it is very important to me that we get to wherever we are going on that as quickly as we can.

Senator HAGAN. OK. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

I want to just start by saying you have really done some remarkable work, Chairman Gensler, over the last 4 years. You have taken on important fights for taxpayers, for consumers. You have shown some real backbone, something that I hope would act as a model for some of the other leaders of our regulatory agencies. You have laid out a road map for the CFTC to follow in the years to come, and you have really done a great job in identifying priorities, where we should be, what we should do.

But I have a specific follow-up question to what you have laid out, and that is, as you know, the CFTC has been under sustained pressure to delay implementing the rules that you have already worked out. And so my question is: Could you comment on how important it is to stick to the timetables that the CFTC has laid out?

Mr. GENSLER. Thank you for that question. I think it is important, one, because 8 million people lost their jobs.

Two, there is still risk in the financial system, and there will always be risk in the financial system. And if we are going to truly end too big to fail, we need to cover and finish off these transparency and risk reduction things.

And then, three, sometimes a deadline just helps people come into compliance. You were a professor. You know that sometimes having those deadlines helps people come into compliance. So we will work with market participants to smooth the transition and, where appropriate, use our tools to give them some relief. But stick to the deadlines.

Senator WARREN. Good. Thank you very much, Mr. Chairman.

I wanted to ask both of you a question about enforcement. We have spoken individually about enforcement multiple times, and recently, Chair White, you announced that the SEC will be requiring admission of guilt in more cases. I think that is a powerfully important step. It shows real toughness in your enforcement strategy and that that will help build leverage, even when you end up with a settlement.

But when I talk about the importance of being willing to take large financial institutions to trial, people tell me, well, it is a real problem because the agencies do not have enough resources in their Enforcement Divisions, and they would have a tough time going up against big Wall Street corporations.

So can each of you discuss whether you have the resources and the importance of resources in having an effective enforcement strategy? Chair White, might I start with you?

Ms. WHITE. Yes. There is no question that additional resources are essential to our successful enforcement strategy, including the change that you are referencing. One of our specific requests in the President's budget is for additional trial attorneys, and we cannot judge at this point how many additional trials we are going to have, but we already do not have enough trial resources. We have to be prepared to go to trial. We are prepared to go to trial. I am really proud of, frankly, the record that the SEC has had in trials. I think it is about 80 percent, when you see it from a defendant's point of view.

One of the things—we need resources across the board for many other things as well, and our budget situation is we are budget neutral, deficit neutral, and, I would certainly hope that we could get that funding. And it really is essential to that strategy.

Senator WARREN. Thank you.

Chairman Gensler.

Mr. GENSLER. We have not shied away from bringing cases against large banks, against exchanges, and sometimes if they do not settle, going straight into court. We are proud of that. But I would say our enforcement resources are tiny compared to the size of the markets, and, you know, the American public put $180 billion into AIG. That is 600 times what the President asked for for funding for our agency. Our enforcement folks are only about 150 of our people. We are trying to make the best decisions, but often we have to delay justice because we do not have the right resources.

Senator WARREN. That is a very important point. Thank you very much. It seems clear that if Congress wants to have a tough watchdog, it needs to make sure that the dog has not been starved, so I appreciate your comments on this.

I have one more question, and that is for you, Chair White. One share/one vote has long been a bedrock principle of corporate governance. In recent years, however, a number of companies—Facebook, LinkedIn, Groupon—have given special insiders voting powers that are far greater than those available to the investing public. This can have short-term benefits, of course, in some cases, but it undermines the basic concept of ownership and says, in effect, that some inside owners can help themselves even if it is at the expense of other outside owners.

Now, last October, the Council of Institutional Investors wrote letters to the New York Stock Exchange and Nasdaq requesting that they prohibit companies seeking an initial listing from having unequal voting rights. I wrote a follow-up letter to the exchange last month. I have not gotten a very encouraging reply.

Chair White, do you support the principle of one share/one vote? And if so, do you have a position on whether or not the exchanges should require it?

Ms. WHITE. I think it is a—the voting rights and the voting rights structure is dictated by State law, actually. But—and the SEC years ago actually attempted to act in this space in that direction, but there was an authority issue that the court overturned the action that the SEC did take.

So if there is to be movement in that direction—and I cannot prejudge it because I would have to judge it when it comes in—it would come from the SROs. In terms of the legal issue, I think, the SEC's possible lack of authority would not necessarily preclude the SROs. They do have a rule that prohibits disenfranchisement, but that is different than what you are talking about.

Senator WARREN. No, I understand that, and the question I was asking is basic support for the idea of one share/one vote.

Ms. WHITE. Well, I certainly support shareholder franchisement to the degree—to the most significant degree possible. But it is not an issue where I think the SEC can act on its own.

Senator WARREN. I understand that limitation. I apologize for going over. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you both for testifying. I wanted to return to the topic that Senator Brown was pursuing.

We have the situation now where we have JPMorgan is in the process of—an examination is underway by FERC of their trading in the electricity markets. Some articles say a settlement is pending, but FERC is talking about eight market manipulation strategies that were used to crank up prices that are unacceptable.

We have certainly the situation with the LIBOR rates more recently. We have the big article in the *New York Times* over aluminum warehouses that Goldman holds. We have the public discussion of the SEC allowing—and, Chair White, correct me if I am wrong, but basically approving JPMorgan to own a significant share of the copper assets with the anticipation of a strategy that might look something like what is happening in aluminum.

I find it fascinating that we have a variety of regulatory powers, but essentially despite those powers dispersed among a number of different agencies, we have a picture of companies, big banks, that have enormous assets being able to buy vast quantities of particular commodities and control of the distribution systems through pipelines, through offshore oil tankers, through warehouses, not only providing a huge amount of market information that is very advantageous in trading, but also in a sense to have a thumb on the scale in terms of supply and demand and be able to have some influence over the price. And if you are simultaneously allowed to bet on the price and you are allowed to have your thumb on the scale reflecting the price, it is a huge conflict of interest.

So in Dodd-Frank and within the Volcker framework, we have conflict-of-interest provisions that provide some powers on this. We certainly have the Fed that has control over commodity trading assets and a reasonable benefit test that is to be applied to that. And, Chair Gensler, as you noted, the CFTC has considerable power regarding market manipulation.

Despite the powers invested in the Fed and the SEC and the CFTC, it seems like there is a huge amount of conflict of interest and a huge amount of market manipulation, and it does not seem like much action. Meanwhile, this is essentially—when these prices go up, it is a huge tax on the economy, whether it is in the price of a beer can or aluminum siding or in the future copper that goes into every electric—the electricity channel through every house, et cetera. Should we expect more? Is the regulatory power too dispersed? What needs to be done? Because essentially the law is written time and time again to try to say such conflicts of interest, such market manipulation, such trading in commodities while you are also betting on the price of commodities is not allowed, and yet somehow we end up with all of that. How are we to explain this? And what is to be done? And maybe I will start with you, Chair Gensler.

Mr. GENSLER. Senator, I could not agree more that these markets matter. And they matter on the dining table at night; they matter for somebody buying a six-pack of beer; they matter when we all fill up a tank of gas; and they even matter when we take out of a mortgage or a student loan. And as you noted LIBOR. We at the CFTC oversee markets for commodities, and commodities and their derivatives, futures, and swaps include even interest rates. We took I think appropriate but tough action about three banks that were readily and pervasively rigging interest rates. We will do similar, if we see it, in—whether it is corn or wheat, whether it is metals, whether it is energy products. The Federal Reserve has authorities as to whether bank holding companies are actually in that space, as you say, that they actually hold those assets. What is critical is that the CFTC ensure that the markets are free of fraud and manipulation and other abuses.

I do think Congress gave us strong tools of enforcement. We need to get the funding behind it, as Senator Warren said. But I do think we have the strong legal tools to do what we are supposed to do.

Senator MERKLEY. Chair Gensler, a number of articles have said what FERC is doing in terms of being an aggressive regulator in manipulation of the electric markets needs to be replicated, if you will, in the metals market. Is that a model that you are looking to as you think about where the agency goes down the road here?

Mr. GENSLER. We have good collaboration with FERC. They take the primary lead in the electricity markets, as you know, as Congress has dictated. And we have some involvement if it is in the futures or swaps on electricity. We principally have used our authorities with regard to those derivatives marketplaces, and I think we will continue to do so. But as I said, and as you pointed out, these are important markets to all Americans.

Senator MERKLEY. Is there such an inherent conflict in owning commodities and the tools that control the flow of those commodities—warehouses, pipelines, et cetera—should it simply be a situation where, if you are in the business of betting on the price, you cannot engage in those commercial activities?

Mr. GENSLER. I think, Senator, the challenge we have is that hedgers, whether you are a farmer, a rancher, thinking about——

Senator MERKLEY. But we are not talking about farmers or ranchers. Those are very small players. We are only talking about a situation where people can own vast shares of a commodity market.

Mr. GENSLER. You are absolutely right. I was just saying there are speculators in the marketplace, and there have been for centuries. The tools Congress gave us are to set appropriate levels, call it "position limits." I think we do need to move forward. That was a rule we finalized. A court vacated it. Two trade associations challenged it in court, and though we are appealing, I think we do need to move forward and finalize those rules.

We do have some interesting provisions in Dodd-Frank that conflicts at large banks, that they have to separate out their research—let us say they are doing research on oil and gas and so forth, and they are trading. So there are conflict-of-interest provisions that we also had. But ultimately it is the Federal Reserve that would decide whether they are in that space at all.

Senator MERKLEY. My time is up, and so, Chair White, I am sorry I do not have time to get your insights. Thank you.

Chairman JOHNSON. I would like to thank Chair White and Chairman Gensler for being here with us today. The implementation of Wall Street reform continues to be a high priority for this Committee, and we appreciate your hard work.

This hearing is adjourned.

[Whereupon, at 11:41 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF MARY JO WHITE

CHAIR, SECURITIES AND EXCHANGE COMMISSION

JULY 30, 2013

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for inviting me to testify on behalf of the Securities and Exchange Commission regarding steps taken by the SEC to reduce systemic risk in our capital markets. In particular, you requested that I discuss the Commission's responsibilities with respect to those aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or the "Act") designed to mitigate systemic risk.

The Commission, of course, recognizes the importance of addressing systemic risk and promoting financial stability. The Dodd-Frank Act gave the SEC significant new responsibilities for, among other things, over-the-counter derivatives, hedge fund and other private fund advisers, municipal advisors, and clearing agencies. The SEC has proposed or adopted rules for over 80 percent of the more than 90 Dodd-Frank Act provisions that require SEC rulemaking, and completing this rulemaking—and the rulemaking called for under the Jumpstart Our Business Startups Act (JOBS Act)—remains a top and immediate priority. It is critical that we execute our responsibilities under both the Dodd-Frank Act and JOBS Act in as timely and smart a way as possible.

Among the Dodd-Frank Act's goals was to decrease the likelihood that an entity's failure will cause a cascading failure across the financial system as a whole. Many of the core provisions of the Act that seek to reduce systemic risks are within the sole jurisdiction of the Federal banking regulators, but other provisions are within the SEC's jurisdiction, either solely or as shared with other regulators. For example, the Act:

- Established a regulatory regime for over-the-counter derivatives transactions, including security-based swaps;
- Enhanced oversight and standards for systemically important financial market utilities, including designated clearing agencies supervised by the Commission;
- Required advisers to many private funds to report data, on a confidential basis, for use in monitoring systemic risk and also supporting the SEC's mission;
- Prohibited banks and their affiliates generally from engaging in proprietary trading, or sponsoring or investing in a hedge fund or private equity fund;
- Altered the regulation of credit rating agencies;
- Prohibited entities that create and distribute asset-backed securities from engaging in certain transactions;
- Established a new orderly liquidation authority for systemically important broker-dealers and other financial entities; and
- Created the Financial Stability Oversight Council (FSOC) to provide a formal structure for coordination among the heads of various financial regulators to monitor systemic risk and to promote financial stability across our Nation's financial system.

Beyond the actions taken in connection with the Dodd-Frank Act, the SEC has tried to diminish systemic risk in the securities markets by, among other things, providing additional safeguards for money market mutual funds.

Below is an overview of the steps the SEC has undertaken to try to mitigate systemic risk in our securities markets, with an emphasis on those actions mandated by the Dodd-Frank Act. [1]

Over-the-Counter Derivatives

Among the key provisions of the Dodd-Frank Act are those that establish a new oversight regime for the over-the-counter (OTC) derivatives marketplace. Title VII of the Dodd-Frank Act (Title VII) requires the Commission to regulate "security-based swaps" and to write rules that address, among other things: mandatory clearing; trade reporting and trade execution; the operation of clearing agencies, trade data repositories, and trade execution facilities; capital and margin requirements and business conduct standards for dealers and major market participants; and public transparency for transactional information. Such rules are intended to achieve a number of goals, including:

[1] A list of the rulemaking provisions in the Dodd-Frank Act applicable to the SEC is attached as Appendix A.

- Facilitating the centralized clearing of swaps, with the intent of reducing counterparty and systemic risk;
- Increasing market transparency for regulators and market participants;
- Increasing security-based swap transaction disclosure; and
- Addressing potential conflict of interest issues relating to security-based swaps.

To date, the Commission has: proposed substantially all of the core rules required by Title VII; adopted a number of final rules and interpretations; provided a "roadmap" to implement Title VII and to inform market participants of the sequence in which the new requirements will become effective and how the proposed rules would apply in a cross border context; and taken other actions to provide legal certainty to market participants during the implementation process. In advancing its regulatory initiatives, the Commission also takes into account the potential disruption and cost to the market. The Commission's more recent Title VII initiatives are discussed below in more detail.

Proposal of Rules Regarding the Application of Title VII in the Cross-Border Context

Given the global nature of the derivatives market, the Commission has been working with its counterparts abroad and the Commodity Futures Trading Commission (CFTC) to coordinate an approach to the regulation of derivatives. In May, the Commission proposed rules and interpretive guidance regarding the application of Title VII to cross-border security-based swap transactions.[2] The proposal includes rules and interpretive guidance that, among other things, would inform parties to a security-based swap transaction about which regulatory requirements apply when their transaction occurs in part within and in part outside the U.S. In addition, the proposal would provide interpretive guidance regarding when a trading platform or clearing agency is required to register with the Commission.

The proposal generally would subject security-based swap transactions to the requirements of Title VII if they are entered into with a U.S. person or otherwise conducted within the United States. In addition, foreign affiliates whose security-based swap transactions are guaranteed by U.S. persons would be subject to certain requirements under Title VII, based on the risk such guaranteed transactions might pose to the U.S. financial system.

Under the proposal, a party may have the ability to comply with Commission requirements by complying instead with some or all of the requirements of a foreign regulatory regime, provided that those requirements have been determined by the Commission to achieve comparable regulatory outcomes. The Commission's proposal refers to this approach as "substituted compliance." Under substituted compliance, a foreign market participant would be permitted to comply with the requirements imposed by its own home country, so long as those requirements achieve regulatory outcomes comparable with the regulatory outcomes of the relevant provisions of Title VII. If the home country does not have any requirements that achieve comparable regulatory outcomes, substituted compliance would not be permitted and the foreign entity would be required to comply with the applicable U.S. requirements. The 60-day reopening of the comment period for certain Title VII rulemaking releases and the policy statement ended July 22, 2013, and the comment period for our proposal on cross-border security-based swap transactions ends August 21, 2013. We are actively reviewing public input on the proposals, as well as the final guidance approved by the CFTC on July 12, 2013.

The Commission has been, and continues to be, strongly supportive of coordination of regulatory reforms to meet the G20 Leaders' commitments to central clearing, trading, and reporting of OTC derivatives. The Commission has been actively engaged in ongoing discussions with foreign regulators regarding the direction of international derivatives regulation and the Commission's efforts to implement the requirements of Title VII, including participation in the Financial Stability Board and the International Organization of Securities Commissions (IOSCO), and engaging in regulatory dialogues with other countries about our respective regulatory reform efforts.

Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants

In July 2012, the Commission adopted final rules and interpretations jointly with the CFTC regarding key product definitions under Title VII, such as the meaning

[2] *See,* Release No. 34-69490, Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants (May 1, 2013), *http://sec.gov/rules/proposed/2012/34-68071.pdf.*

of "swap" and "security-based swap."[3] This effort followed the joint adoption of entity definitions by the Commission and the CFTC in April 2012, which further defined the key terms "swap dealer" and "security-based swap dealer," provided guidance as to what constitutes dealing activity, and implemented the Dodd-Frank Act's "major security-based swap participant" definition.[4]

In October 2012, the Commission proposed rules that would, among other things, prescribe how much capital security-based swap dealers would need to maintain, when and how these dealers would need to collect margin collateral to protect against counterparty losses, and how these dealers would need to segregate and protect customer funds and securities.[5] The proposal also would establish capital and margin collateral requirements for major security-based swap participants and raise capital requirements for certain large broker-dealers that use internal models in computing capital. The proposal would further require those large broker-dealers and security-based swap dealers to compute capital utilizing internal models, perform a liquidity stress test at least monthly, and maintain liquidity reserves sufficient to address potential funding needs during a stress event.

Taken together, the goal of these rules is to help ensure that market participants remain highly liquid and well capitalized so that they can meet their obligations to customers and counterparties without creating unnecessary burdens that impede liquidity and efficient capital formation. In addition, in the event of a failure, enhanced capital, margin, and customer segregation rules should help ensure that customers and counterparties will be protected, thus limiting systemic effects in the capital markets and the broader economy.

Requirements for Security-Based Swap Clearing Activity

Title VII of the Dodd-Frank Act requires that an entity acting as a clearing agency with respect to security-based swaps register with the Commission and that the Commission adopt rules with respect to clearing agencies that clear security-based swaps. As described below, in October 2012, the Commission adopted a rule that establishes operational and risk management standards for clearing agencies, including clearing agencies that clear security-based swaps. In June 2012, the Commission adopted rules that establish procedures for its review of certain actions undertaken by clearing agencies. These rules include provisions detailing how clearing agencies will provide information to the Commission about the security-based swaps the clearing agencies plan to accept for clearing, which will then be used by the Commission to aid in determining whether those security-based swaps are required to be cleared.

Financial Market Utilities

Title VIII of the Dodd-Frank Act (Title VIII) aims to mitigate systemic risk in the financial system and promote financial stability by providing for increased regulation of financial market utilities[6] (FMUs) and financial institutions engaging in payment, clearing, and settlement activities that are designated as systemically important.

Enhanced Standards for Systemically Important Financial Market Utilities

Under Title VIII, FSOC is authorized to designate an FMU as systemically important if the failure, or a disruption to the functioning, of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening the stability of the U.S. financial system. FSOC established an interagency FMU designations committee to develop a framework for the designation of systemically important FMUs. In July 2012, FSOC designated eight FMUs as systemically important under Title VIII (DFMUs), and the Commission acts as primary supervisory agency for four of these: the De-

[3] *See,* Release No. 33-9338, Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (July 18, 2012), *http://www.sec.gov/rules/final/2012/33-9338.pdf.*

[4] *See,* Release No. 34-66868, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant" (April 27, 2012), *http://www.sec.gov/rules/final/2012/34-66868.pdf.*

[5] *See,* Release No. 34-68071, Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Oct. 18, 2012), *http://www.sec.gov/rules/proposed/2012/34-68071.pdf.*

[6] Section 803(6) of the Dodd-Frank Act defines a financial market utility as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

pository Trust Company, Fixed Income Clearing Corporation, National Securities Clearing Corporation, and The Options Clearing Corporation.[7]

Title VIII provides a framework for an enhanced supervisory regime for DFMUs, including oversight in consultation with the Federal Reserve Board (Federal Reserve) and FSOC. It permits the Commission to prescribe regulations for risk management and operations, and also directs the Commission to take into consideration relevant international standards and existing prudential requirements for the DFMUs it supervises.[8] The Commission is also required to examine such DFMUs annually.

Title VIII also establishes a process for a DFMU to submit to the Commission, with a copy to the Federal Reserve, advance notices identifying changes to its rules, procedures, or operations that could materially affect the nature or level of risk presented by the FMU.[9] In June 2012, the Commission adopted rules that establish procedures for how it will address these advance notices,[10] and it has since considered a significant number of such notices.[11]

Adoption of Clearing Agency Standards

Clearing agencies play a critical role in financial markets by ensuring that transactions settle on time and on agreed-upon terms. To enhance the integrity of clearing agency operations and governance, the Commission adopted rules in October 2012 requiring all registered clearing agencies—including, as noted above, clearing agencies that clear security-based swaps—to maintain certain standards with respect to risk management and operations.[12] The rules contain specific requirements for clearing agencies that perform central counterparty services, including, for example, written policies and procedures addressing measuring credit exposures, use margin requirements, maintaining financial resources sufficient to withstand defaults, and fair and reasonable membership opportunities for persons who are not dealers or security-based swap dealers. The requirements are designed to strengthen the Commission's oversight of securities clearing agencies and promote consistency in the regulation of clearing organizations generally, thereby helping to ensure that clearing agency regulation reduces systemic risk in the financial markets.

Form PF: Systemic Risk Reporting by Advisers to Private Funds

Title IV of the Dodd-Frank Act directed the Commission to establish reporting requirements for investment advisers to private funds as necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk by the FSOC.[13] The Dodd-Frank Act specifies that such reporting must include certain information about private funds, including but not limited to the amount of assets under management, use of leverage, counterparty credit risk exposure, and trading practices for each private fund managed by the adviser.[14] The Commission implemented this provision of the Dodd-Frank Act when it adopted Form PF in October 2011, a systemic risk reporting form for advisers to private

[7] Two other clearing agencies registered with the Commission are designated systemically important for which the CFTC is the primary supervisory agency: Chicago Mercantile Exchange, Inc. and ICE Clear Credit LLC. The Federal Reserve Board acts as primary supervisory agency for two payment systems that were designated as systemically important FMUs: CLS Bank International and the Clearing House International Payments System.

[8] *See,* §805(a)(2) of the Dodd-Frank Act. Commission staff also worked jointly with the staffs of the CFTC and the Federal Reserve to submit a required report to Congress in July 2011 discussing recommendations regarding risk management supervision of clearing entities that are DFMUs. Risk Management Supervision of Designated Clearing Entities, Report by the Commission, Board and CFTC to the Senate Committees on Banking, Housing, and Urban Affairs and Agriculture in fulfillment of Section 813 of Title VIII of the Dodd-Frank Act (July 2011), *http://www.sec.gov/news/studies/2011/813study.pdf.* The report discussed several recommendations, including finalizing rulemakings to establish enhanced risk management for such clearing entities, formalizing the process for ongoing consultations and information sharing regarding such clearing entities and systemic risk, and enhancing clearing entity examinations.

[9] *See,* §806(e)(4) of the Dodd-Frank Act.

[10] *See,* Release No. 34-67286, Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations (June 28, 2012), *http://www.sec.gov/rules/final/2012/34-67286.pdf.*

[11] Advance notices are published on the Commission Web site at ***http://www.sec.gov/rules/sro.shtml.***

[12] *See,* Release No. 34-68080, Clearing Agency Standards (October 22, 2012), *http://www.sec.gov/rules/final/2012/34-68080.pdf.*

[13] Section 404 of the Dodd-Frank Act (codified at Section 204(b) of the Investment Advisers Act of 1940, as amended).

[14] Section 404 of the Dodd-Frank Act.

funds.[15] As required by the Dodd-Frank Act, Form PF was designed in consultation with FSOC. To date, approximately 2,300 investment advisers managing over $7 trillion in private fund assets have filed approximately 4,000 reports on Form PF concerning approximately 6,700 hedge funds, 66 liquidity funds and 5,900 private equity funds.

The requirement to file Form PF applies to investment advisers registered with the Commission that advise one or more private funds and have at least $150 million in private fund assets under management at the end of the adviser's most recently completed fiscal year. The filing requirements of Form PF vary depending on the size of the adviser. Both the amount of information required to be reported and the frequency with which Form PF must be filed depend on the amount of the adviser's assets under management and the types of funds it advises.[16] Most advisers are required to file Form PF once a year, and report basic information regarding the private funds they advise, such as the types of private funds that an adviser advises, and information relating to such funds' size, leverage, types of investors, liquidity, and performance. Advisers managing hedge funds must also report information about fund strategy, counterparty credit risk, and the use of trading and clearing mechanisms.

To comply with enhanced confidentiality provisions established under the Dodd-Frank Act with respect to Form PF, Commission staff has been developing a secure filing environment for Form PF to protect the information when and after it is filed, including controls and systems to handle the data across the agency and to deliver the data electronically to the Office of Financial Research (OFR) within the Department of the Treasury. As of May 1, 2013, the Commission received a complete set of initial Form PF filings from those investment advisers required to file. Commission staff has started to use the data in carrying out the Commission's regulatory mission, including examinations, investigations, and investor protection efforts.

The Volcker Rule

Section 619 of the Dodd-Frank Act (known as the "Volcker Rule") generally prohibits and restricts banks, bank affiliates, and certain nonbank financial companies from engaging in proprietary trading, or sponsoring, investing, or having certain interests or relationships with a hedge fund or private equity fund. The statute provides exceptions to these prohibitions for certain customer-service oriented activities, such as market making, underwriting, and, subject to certain limitations, organizing and offering hedge funds and private equity funds as part of bona fide trust, fiduciary, or investment advisory services provided to a bank's customers.

In October 2011, the Federal banking agencies and SEC jointly proposed rules to implement the Volcker Rule.[17] In January 2012, the CFTC issued a substantially similar proposal. To date, we have received nearly 19,000 comment letters in response to the proposal. SEC staff has carefully reviewed these comments and continues to engage in regular and active consultation with the staffs at our fellow Federal financial regulators to develop recommendations for implementing the Volcker Rule in ways that advance the goals of Section 619 while also limiting the potential for unintended market impacts.

Credit Rating Agencies

The Dodd-Frank Act required the Commission to undertake a number of rulemakings related to credit rating agencies registered as nationally recognized statistical rating organizations, or "NRSROs." The Commission has proposed a series of rules intended to strengthen the integrity of credit ratings by, among other things, improving the transparency of ratings methodologies and performance.[18]

Additionally, the Dodd-Frank Act required each Federal agency, to the extent applicable, to review its regulations that require use of credit ratings as an assessment of the creditworthiness of a security, remove these references, and replace them

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[15] *See,* Release No. IA-3308, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF (Oct. 31, 2011), *http://www.sec.gov/rules/final/2011/ia-3308.pdf.*

[16] Large private fund advisers must provide more detailed information than smaller private fund advisers. The content and frequency of this more detailed reporting is different depending on the type of private fund the large adviser manages. For example, advisers with $1.5 billion or more in hedge fund assets under management must report on risk metrics, financing information, and fund exposure for each hedge fund managed that has a net asset value of at least $500 million.

[17] *See,* Release No. 34-65545, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (October 12, 2011), *http://www.sec.gov/rules/proposed/2011/34-65545.pdf.*

[18] Release No. 34-64514, Proposed Rules for Nationally Recognized Statistical Rating Organizations (May 18, 2011), *http://www.sec.gov/rules/proposed/2011/34-64514.pdf.*

with appropriate standards of creditworthiness. The Commission has proposed and, in some cases, adopted amendments to a number of its rules to remove references to credit ratings.[19] The Commission plans to take further action in the near term to complete implementation of these mandates.

The Dodd-Frank Act also required the Commission to study the credit rating process for structured products and the conflicts of interest associated with the issuer-pay and subscriber-pay rating agency models, and to examine the feasibility of establishing an assigned ratings system or alternative means for compensating NRSROs. In December 2012, the Commission submitted a required report to Congress containing the findings of the study and recommendations for regulatory or statutory changes that should be made to implement the findings of the study.[20] In May 2013, the Commission held a roundtable dedicated to these topics.

Prohibition Against Conflicts of Interest in Certain Securitizations

In September 2011, the Commission proposed a rule to implement Section 621 of the Dodd-Frank Act, which prohibits entities that create and distribute asset-backed securities from engaging in transactions that involve or result in material conflicts of interest with respect to the investors in such asset-backed securities.[21] The proposed rule would prohibit underwriters, placement agents, initial purchasers, and sponsors of an asset-backed security, among others, from engaging in any transaction that would involve or result in any material conflicts of interest with respect to any investor in the relevant asset-backed security.

The Commission received a number of comment letters discussing a range of complex issues, including the ability of portfolio managers to hedge the credit risk that a bank holds on its balance sheet through synthetic securitizations. Commission staff is carefully considering each of the issues and concerns raised in the comment letters.

Orderly Liquidation Authority

Title II of the Dodd-Frank Act created a new process, modeled on the receivership process used for failed banks, pursuant to which the Federal Deposit Insurance Corporation (FDIC) may serve as receiver for certain large financial companies, including broker-dealers, whose failure poses a significant risk to financial stability in the United States. Under Title II, the Commission and the FDIC are required to develop joint rules governing the orderly liquidation of broker-dealers, and the Commission staff is working to prepare a recommendation for the Commission's consideration. The rules should provide greater certainty and transparency regarding the process the FDIC would follow during the orderly liquidation of a systemically important broker-dealer.

Other Commission Actions Addressing Potential Systemic Risks

Beyond actions taken in connection with the implementation of the Dodd-Frank Act, the Commission has taken additional steps to further reduced systemic risk in our securities markets.

Enhancing Operational Integrity

Nearly all trading in the equity and options markets today depends on the reliable performance of highly automated systems, as reliance on technology has enabled the markets to achieve extraordinary levels of speed and efficiency. When technology systems do not work as intended, however, the failures can harm not only the operator of the system, but also a wide range of other market participants.

In November 2010, the Commission adopted a new Market Access Rule to require broker-dealers with market access to put in place risk management controls and su-

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[19] *See,* Release No. IC-No. 30268, Purchase of Certain Debt Securities by Business Development Companies Relying on an Investment Company Act Exemption (Nov. 19, 2012), *http://www.sec.gov/rules/final/2012/ic-30268.pdf;* Release No. 34-67448, Commission Guidance Regarding Definitions of Mortgage Related Security and Small Business Related Security (Jul. 17, 2012), *http://www.sec.gov/rules/interp/2012/34-67448.pdf;* Release No. 34-9245, Security Ratings (Jul. 27, 2011), *http://www.sec.gov/rules/final/2011/33-9245fr.pdf;* Release No. 34-9244, Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment (Jul. 26, 2011), *http://www.sec.gov/rules/proposed/2011/33-9244fr.pdf;* Release No. 34-64352, Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934 (Apr. 27, 2011), *http://www.sec.gov/rules/proposed/2011/34-64352.pdf;* Release No. IC-9193, References to Credit Ratings in Certain Investment Company Act Rules and Forms (Mar. 3, 2011), *http://www.sec.gov/rules/proposed/2011/33-9193fr.pdf.*

[20] *See,* Report to Congress on Assigned Credit Ratings (December 2012), *http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf.*

[21] *See,* Release No. 34-65355, Prohibition Against Conflicts of Interest in Certain Securitizations (September 19, 2011), *http://www.sec.gov/rules/proposed/2011/34-65355.pdf.*

pervisory procedures on a pretrade basis. Among other things, the rule requires any broker using or providing access to trading on the securities markets to implement pretrade controls reasonably designed to manage the financial, regulatory, and other risks of such access.

In March of this year, the Commission proposed Regulation Systems Compliance and Integrity (Regulation SCI),[22] which would require exchanges, certain alternative trading systems, clearing agencies, and plan processors to maintain policies and procedures reasonably designed to meet certain technology standards, and take appropriate corrective action if problems do occur. The comment period for proposed Regulation SCI closed on July 8, and Commission staff is currently in the process of reviewing the comment letters.

Addressing Significant Market Volatility

The Commission also recently approved a National Market System (NMS) Plan to implement a "limit up–limit down" mechanism to create "speed bumps" to limit abrupt market movements in individual securities,[23] and amendments to the marketwide circuit breakers to provide for brief, coordinated, cross-market trading halts during a sharp decline in the securities market.[24] The marketwide circuit breakers and phase I of the NMS Plan relating to the limit up–limit down mechanism were implemented on April 8, 2013.[25]

Money Market Funds

While there are many possible explanations for the redemptions from money market funds during the 2007–2008 financial crisis, regardless of the cause or causes, money market funds' experience in the 2007–2008 financial crisis demonstrates the harm that can result from rapid heavy redemptions in money market funds. Since that time, the Commission and its staff have reexamined the Commission's regulation of money market funds. This effort began with the Commission's 2010 reforms to money market fund regulation, followed by a 2011 Commission roundtable on money market funds and systemic risk, a new and detailed study in 2012 by SEC economists, and most recently a June 2013 proposal requesting public comment on additional reforms to the Commission's regulation of money market funds.[26] The staff also has used data collected from money market funds on Form N–MFP to monitor trends and risks in this area, which was particularly useful during the Eurozone sovereign debt crisis.

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[22] *See,* Release No. 34-69077, Regulation Systems Compliance and Integrity (March 8, 2013), *http://www.sec.gov/rules/proposed/2013/34-69077.pdf.*

[23] *See,* Release No. 67091, Order Approving, on a Pilot Basis, the National Market System Plan To Address Extraordinary Market Volatility by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc. (May 31, 2012), *http://www.sec.gov/rules/sro/nms/2012/34-67091.pdf;* Release No. 34-68953, Notice of Filing and Immediate Effectiveness of the Second Amendment to the Limit Up–Limit Down Plan (February 20, 2013), *http://www.sec.gov/rules/sro/nms/2013/34-68953.pdf;* Release No. 34-69287, Order Approving the Third Amendment to the Limit Up–Limit Down Plan (April 3, 2013), *http://www.sec.gov/rules/sro/nms/2013/34-69287.pdf.*

[24] *See,* Release No. 34-67090, Notice of Filing of Amendments No. 1 and Order Granting Accelerated Approval of Proposed Rule Changes as Modified by Amendments No. 1, Relating to Trading Halts Due to Extraordinary Market Volatility (May 31, 2012), *http://www.sec.gov/rules/sro/bats/2012/34-67090.pdf*. The operative date of the revised circuit breakers was delayed from February 4, 2013, to April 8, 2013. *See,* e.g., Release No. 34-68784, Notice of Filing and Immediate Effectiveness of Proposed Rule Change Delaying the Operative Date of a Rule Change to NYSE Rule 80B, Which Provides for Methodology for Determining When To Halt Trading in All Stocks Due to Extraordinary Market Volatility, From the Date of February 4, 2013, Until April 8, 2013 (January 31, 2013), *http://www.sec.gov/rules/sro/nyse/2013/34-68784.pdf.*

[25] Phase I applies the limit up–limit down mechanism to stocks in the S&P 500, the Russell 1000, and to select exchange-traded products. Phase II, currently scheduled for implementation in November 2013, will apply to all remaining exchange-traded equity securities, and will be implemented 6 months following the implementation of Phase I.

[26] *See,* Release No. IC-30551, Money Market Fund Reform; Amendments to Form PF (Jun. 5, 2013), *http://www.sec.gov/rules/proposed/2013/33-9408.pdf;* Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, a report by staff of the Division of Risk, Strategy, and Financial Innovation (Nov. 30, 2012), *http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf;* U.S. Securities and Exchange Commission, Roundtable on Money Market Funds and Systemic Risk, unofficial transcript (May 10, 2011), *http://www.sec.gov/spotlight/mmf-risk/mmf-risk-transcript-051011.htm;* Release No. IC-29132, Money Market Fund Reform (Feb. 23, 2010), *http://www.sec.gov/rules/final/2010/ic-29132.pdf.*

The Commission's recent proposal requests comment on a variety of reforms designed to reduce money market funds' susceptibility to heavy redemptions, to mitigate potential contagion effects from heavy redemptions, and to increase the transparency of their risks, while preserving the benefits of this product to both retail and institutional investors to the extent possible. There are two principal reform proposals—which could be adopted separately or in combination. The first—would require that all prime institutional money market funds operate with a floating net asset value. The second would require that all non-Government money market funds impose a 2 percent liquidity fee if the fund's level of weekly liquid assets fell below 15 percent of its total assets, unless the fund's board determined that it was not in the best interest of the fund. The second reform alternative also would permit the fund's board of directors to temporarily suspend redemptions in the fund for up to 30 days if it crossed that liquidity threshold. With respect to both alternatives, the proposed reforms also would tighten diversification requirements, enhance disclosure requirements, improve data reporting on both registered and unregistered money market funds, and strengthen fund stress testing. We look forward to receiving public input on the proposal and whether it strikes the right balance between addressing systemic risk concerns while also maintaining money market funds as a viable investment product. The 90-day comment period ends in mid-September.

Financial Stability Oversight Council

Title I of the Dodd-Frank Act provides that the Chairman of the Commission shall serve as a voting member of FSOC. [27] Pursuant to the Dodd-Frank Act, the purposes of the Council are:

- Identifying risks to the financial stability of the United States that could arise from the material financial distress or failure—or ongoing activities—of large, interconnected bank holding companies or nonbank financial holding companies, or that could arise outside the financial services marketplace;
- Promoting market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and
- Responding to emerging threats to the stability of the United States financial system. [28]

In addition, FSOC provides a formal structure for coordination among the various financial regulators. As Chairman of the SEC, I participate in the activities of the Council, including consideration of designation of certain nonbank financial companies as systemically important financial institutions (SIFIs) subject to heightened prudential supervision by the Board of Governors of the Federal Reserve System (Federal Reserve Board). [29]

Conclusion

The Commission recognizes the importance of limiting systemic risk in our financial markets and is committed to taking appropriate steps to address systemic threats to our financial system in a balanced manner that preserves the strengths of the system and protects investors. Thank you for inviting me to testify today. I would be happy to answer any questions you may have.

[27] Dodd-Frank Act §111(b)(1).

[28] Dodd-Frank Act §112(a)(1)(E).

[29] *See,* Dodd-Frank Act §§112(a)(2)(H) and 113. *See also,* "Financial Stability Oversight Council Makes First Nonbank Financial Company Designations To Address Potential Threats to Financial Stability" (Jul. 9, 2013), *http://www.treasury.gov/press-center/press-releases/Pages/jl2004.aspx.*

APPENDIX A

Appendix A

The following is a list of rulemaking provisions in the Dodd-Frank Act applicable to the SEC. The provisions are divided into three categories, depending on whether the SEC has issued final rules, proposed rules, or has not issued a rulemaking release with respect to each provision.

Final Rules

Sec. 404—Records to be maintained and reports to be provided by private funds (Form PF)

Sec. 406—Disclosure rules on private funds

Sec. 407—Exemption of venture capital fund advisers, definition of "venture capital fund"

Sec. 408—Exemption from registration by certain private fund advisers

Sec. 409—Family office

Sec. 410—Asset threshold for federal registration of investment advisers

Sec. 411—Custody of client accounts by registered investment advisers (completed prior to Dodd-Frank Act)

Sec. 413(a)—Adjustment of the accredited investor standard

Sec. 418—Qualified client standard, inflation adjustment

Sec. 712—Joint CFTC and SEC rulemaking regarding mixed swaps

Sec. 712(d)(1)—Joint CFTC and SEC rulemaking concerning swaps-related definitions

Sec. 712(d)(2)(B)—Joint CFTC and SEC rulemaking regarding recordkeeping by trade repositories with respect to security-based swaps transactions

Sec. 712(d)(2)(C)—Joint CFTC and SEC rulemaking regarding recordkeeping by dealers and participants for security based swap transactions

Sec. 742(c)—Rules applicable to retail commodity transactions

Sec. 761(b)—Rules to further define "commercial risk" and other terms

Sec. 761(a)(6)—Rules to facilitate identification of major security-based swap participants

Sec. 761(a)(6)—Exemption from the definition of security-based swap dealer for *de minimis* activity

Sec. 763(a)—Rules to request information from persons claiming the end-user exception and prevent abuse of exceptions to swap rules

Appendix A

Sec. 763(a)—Rules providing process for clearing agencies to submit information to the SEC about security-based swaps to determine whether they should be subject to a mandatory clearing requirement (it is possible there may be additional rules)

Sec. 763(a)—Rules for providing a process for staying a clearing requirement and reviewing clearing arrangements for swaps approved by the SEC for clearing (it is possible there may be additional rules)

Sec. 763(a)—Rules to prevent evasion of clearing requirements (it is possible there may be additional rules)

Sec. 763(b)—Rules governing clearing agencies for security-based swaps

Sec. 766(a)—Transition rules regarding the reporting of pre-enactment security-based swap transactions

Sec. 766(b)—Beneficial ownership reporting for certain security-based swaps

Sec. 805(a)(2)(A)—Authority to prescribe risk management standards for designated clearing entities

Sec. 806(e)(1)—Procedures for changes to rules, procedures or operation of designated financial market utilities

Sec. 916—Streamlining of filing procedures for self-regulatory organizations

Sec. 924—Whistleblower provisions

Sec. 926—Disqualifying felons and other "bad actors" from Regulation D offerings

Sec. 929W—Notice to missing security holders

Sec. 939A—Review of reliance on credit ratings (some removals of references to ratings are in the proposed stage)

Sec. 939B—Elimination of exemption from fair disclosure rule

Sec. 942(a)—Suspension of section 15(d) duty to file

Sec. 943—Representations and warranties in asset-backed securities offerings

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Sec. 952—Compensation committee independence—Direction of SROs to take action to prohibit listing of certain securities unless issuers comply with independence requirements

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Sec. 984(a)—Additional rulemaking authority regarding transparency of information available to brokers, dealers, and investors with respect to loan or borrowing of securities

Sec. 984(b)—Increased transparency of information available to brokers, dealers, and investors with respect to loan or borrowing of securities

Completed Studies and Reports Required by the Dodd-Frank Act

Sec. 342—Report to Congress on the activities of the Office of Minority and Women Inclusion

Sec. 719(b)—Report to Congress, jointly with the CFTC, regarding a study regarding the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions

Sec. 719(c)—Report to Congress, jointly with the CFTC, regarding a study regarding how swaps are regulated in the United States, Asia, and Europe, to identify areas of regulation that are similar and could be harmonized.

Sec. 813—Report to Congress, jointly with the CFTC and the Federal Reserve, on risk management supervision of designated clearing entities

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Sec. 913—Report to Congress on the study of the obligations of brokers, dealers, and investment advisers

Sec. 914—Report to Congress on the need for enhanced resources for investment adviser examinations and enforcement

Sec. 917—Study regarding financial literacy among retail investors

Sec. 919B—Study of ways to improve investor access to information about investment advisers and broker-dealers

Secs. 922 and 924—Report to Congress on the securities whistleblower incentive and protection program

Sec. 929Y—Study on the cross-border scope of the private right of action under Section 10(b) of the Securities Exchange Act

Sec. 932—Summary report of Commission staff's examinations of NRSROs

Sec. 939(h)—Report to Congress on standardization within certain elements of the credit rating process

Sec. 939A—Report to Congress on review of reliance on credit ratings

Sec. 939F—Study on the rating process for structured finance products and the feasibility of an assignment system

Sec. 961—Report and certification sent to Congress regarding internal supervisory controls

Sec. 967—Report to Congress on the implementation of SEC organizational reform recommendations

Sec. 989G—Report to Congress on study regarding reducing the costs to smaller issuers (with market capitalization between $75 million and $ 250 million) for complying with §404(b) of the Sarbanes-Oxley Act of 2002

PREPARED STATEMENT OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

JULY 30, 2013

Good morning Chairman Johnson, Ranking Member Crapo, and Members of the Committee. Thank you for inviting me to today's hearing. I am pleased to testify along with Securities and Exchange Commission (SEC) Chair Mary Jo White.

Today's hearing comes at an historic moment in the CFTC's effort to implement the much-needed reforms of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Now, 3 years since passage of the Dodd-Frank Act, I am pleased to report that we have nearly completed all of the necessary rule writing. Market participants are well along the path of implementing these reforms.

These reforms for the first time shine a light on a marketplace that has been opaque for far too long. These reforms mitigate risk and broaden market access through central clearing of standardized derivatives. These reforms for the first time bring oversight to swap dealers and major swap participants—some of whom were at the center of the bailouts of the financial crisis 5 years ago. I thank my fellow commissioners and the staff of the Commodity Futures Trading Commission (CFTC) for all of their hard work, dedication, and collaboration in bringing oversight to the swaps marketplace.

Introduction

The public and the economy benefit from swap market reforms, just as the public benefited from the historic reforms in the securities and futures markets since the 1930s. For the first time, we have in place a legal and regulatory foundation for the vast swaps markets that brings transparency and lowers risk for the American public. This new comprehensive regulatory regime includes robust rules of the road to benefit those who trade swaps as well as those who have never even heard of them.

In 2008, we witnessed widespread failure throughout the financial system and financial regulatory system. The lack of important oversight in the swaps market—oversight that we've had for decades in the securities and futures markets—allowed for risk to accumulate and be passed on to the public in the form of taxpayer-funded bailouts. Taxpayers sent $182 billion to AIG alone. And AIG was just one part of the larger financial crisis that nearly took down the U.S. and global economies.

Middle class Americans paid the price of the 2008 financial crisis with their jobs, their pensions and their homes. The crisis cost eight million jobs and thousands of businesses, and the swaps market was right at the center. Americans are remarkably resilient, but they do expect us to learn from the lessons of the crisis and to do everything possible to prevent this from happening again. That is why Congress passed the Dodd-Frank Act and why the hard working staff of the CFTC have worked so diligently to implement its reforms.

These rules are complementary pieces of an interconnected foundation on which the swaps market will operate in a transparent, open and competitive manner. Further, just as we have complementary commonsense rules for our roads—traffic lights, stop signs, and speed limits, and cops on the streets to enforce all these rules—we need commonsense rules of the road for the swaps markets. In 2008, we had AIG recklessly driving toward failure, and it, along with other failing financial institutions, were so big that they injured millions of bystanders.

Americans would never accept a city or highway system with no rules, no streetlights, no traffic lights, and no cops.

And now, with the near-completion of swaps market reforms, the American public no longer will need to accept a dark swaps market lacking commonsense rules of the road.

Credit should be shared for this reform with the SEC. We have worked collaboratively with the SEC, sharing our internal memos, term sheets, and draft regulations and seeking advice and counsel every step of the way. In addition to the consultation, Congress tasked the CFTC and SEC with jointly completing a number of critical, foundational rules further defining swap dealers and swaps, among other terms. It is only with this close work and collaboration that reform came to life. We also significantly benefited from collaboration with other U.S. and international regulators.

We have completed this reform sensitive, as Congress was, that nonfinancial firms, responsible for 94 percent of private sector jobs in this country, only make up approximately 10 percent of the swaps market. Congress directed that these nonfinancial end users have a choice about central clearing, and our rules reflect that. Consistent with Congress's direction related to clearing, the CFTC has proposed that margin for uncleared swaps does not have to be collected from nonfinancial end users. We also have ensured that treasury affiliates of nonfinancial end users will have a choice about central clearing. Further, we granted relief for inter-affiliate clearing and reporting as long as outward-facing transactions are cleared and reported.

I now will walk you through the three key areas of completed reforms: transparency, central clearing, and oversight of swap dealers and other intermediaries.

Transparency and Access—Lowering Cost and Increasing Liquidity, Efficiency, and Competition

A key benefit of swaps reform is providing critical transparency and access to businesses and other end users that use the swaps market to lock in a price or hedge a risk. Transparency and access—longstanding hallmarks of the futures market, both before and after the trade—lower costs for investors, consumers, and businesses.

When light shines on a market, the economy and public benefit. Transparency increases liquidity, efficiency, and competition. It is the nonfinancial part of our economy that provides 94 percent of private sector jobs in the United States and will most benefit from transparency and access to markets. Even amongst financial entities, pension funds, community banks, insurance companies, and other nondealers will significantly benefit as they manage the savings and security of Americans.

Based upon completed reforms, the public and regulators already are benefiting from significant new transparency. Starting late last year, financial regulators have been able to look at swaps transactions that are now being reported to swap data repositories. The phased implementation of these reporting requirements is nearly complete, with just one remaining group of U.S. transactions coming into data repositories August 19. Additional reporting from offshore swap dealers will phase in later this fall.

We now have pricing, transactional, counterparty and valuation information in the data repositories for more than $360 trillion in outstanding swaps. This covers all the different asset classes, including interest rate swaps, credit index swaps, foreign currency swaps, energy swaps, metals swaps, and agriculture swaps. We already are benefiting at the CFTC, reviewing this data for purposes of our oversight and surveillance.

Congress knew, though that transparency to the regulators is not enough. Markets work best when the public benefits from seeing the price and volume of transactions after they have been executed. Beginning this past January, the public can now see the prices and volume of transactions on a time delayed basis (and in a way that masks counterparties), similar to a modern-day ticker tape, free of charge and available on the Internet. Further, starting today, July 30, a significant portion of the smaller-size transactions will no longer be reported on a time-delayed basis. This fulfills Congress's mandate that transactions below a block size be publicly reported "as soon as technologically practicable."

As the Commission recently finalized block rules for swaps, it will shortly turn to consider staff recommendations for a proposal on a futures block rule.

In addition, for the first time, all swaps trading facilities will have to register, completing the task of closing what had come to be known as the "Enron loophole." We accomplished this through finalizing rules relating to swap execution facilities (SEFs), which are trading facilities for the transaction of swaps. SEFs already have started to register, and some are likely to be operating by August 5. Others will need to register and include the minimum trading functions, such as an order book, by October 2. All market participants shortly will have the ability to compete by making bids and offers to each other through an order book. They also benefit by seeing the prices of such orders prior to making a decision on a transaction.

Thus, market participants, whether they be pension funds, asset managers, community banks or other end users, shortly will be able to go onto a centralized market structure—a designated contract market (DCM) or a SEF—and execute their swaps transactions in a competitive marketplace, while in the past they were primarily only able to do this directly with dealers. This is a critical benefit to our overall economy. When transparency and competition come to a marketplace, costs go down.

Further, standardized swaps (swaps that are subject to the clearing requirement and made available for trading) will be subject to a trade execution requirement likely starting by early next year. A significant portion of interest rate and credit derivative index swaps will be in full view to the marketplace before transactions occur. Trading platforms also can elect to offer other types of swaps for transparent trading. This is a significant shift toward market transparency from the way it used to be.

As Congress made clear in the law, trades will be required to be executed on SEFs or DCMs only when financial institutions transact with financial institutions. Nonfinancial commercial companies and other end users will benefit from access to the information on these platforms, but will not be required to use them. Further, companies will be able to continue relying on customized transactions—those not required to be cleared—to meet their particular needs, as well as to enter into large block trades.

Beyond these reforms, new CFTC rules brought additional transparency earlier this year, as customers can now see the valuation of their positions on a daily basis—either as reported by the clearinghouse or by their swap dealers as required by business conduct rules.

With these transparency reforms, the public and regulators now have their first full window into the swaps marketplace. These reforms build upon the democratization of the swaps market that is coming with the clearing of standardized swaps.

Central Clearing—Mitigating Risk and Promoting Access

Transparency is but one critical rule of the road in the swaps markets. It provides the street lamps that light the roads, but we also must ensure that the streets are safe for driving and that drivers have easy access to the highways.

Clearinghouses have operated in the futures markets since the late 19th century to lower risk and improve access for market participants. Clearinghouses reduce the risk that one entity's failure could spread to the public by standing between the parties and maintaining resources to cover defaults. They value every position daily and require the parties to post adequate margin on a regular basis. Clearing also fosters access for the broad market as it ensures that each participant no longer has to individually worry about its counterparty's credit characteristics.

The CFTC has implemented the two principal reforms of the Dodd-Frank Act relating to clearing.

First, consistent with the direction of the statute, the Commission in the fall of 2011 adopted a comprehensive set of rules for the risk management of clearinghouses. These final rules provided a strong set of protections for customer money posted to clearinghouses, including for the first time a requirement for gross margining as well as segregation of customer money at the clearinghouse.

These final rules were consistent with international standards as of the time that our rules were published. Subsequently, new international standards have been adopted—the Principles for Financial Market Infrastructures. Though the Commission's clearinghouse risk management rules cover the vast majority of these new international standards, CFTC staff is working expeditiously to recommend the necessary steps to implement the remaining items that should be incorporated in our rules. Most importantly, Commissioners currently are considering finalizing a rule requiring systemically important clearinghouses to have prefunded default resources sufficient to cover the default of the two clearing members that would cause the greatest loss (after margin) in extreme but plausible circumstances.

Second, the CFTC adopted rules to implement the Dodd-Frank Act's requirement that standardized swaps be cleared. The Commission approved the first clearing requirement last November, following through on the U.S. commitment at the 2009 G20 meeting that standardized swaps be cleared by the end of 2012. The Commission has determined that swaps in four interest rate swap classes (U.S. Dollar, Euro, Sterling, and Yen) and in two credit index swap classes (CDX and iTraxx) are subject to the clearing requirement. These asset classes account for the vast majority of interest rate and credit default index swaps.

We reached a key milestone in March when the clearing requirement for swap dealers and the largest hedge funds went into effect. Additional financial entities began clearing June 10. Compliance will continue to be phased in throughout this year. Accounts managed by third party investment managers and ERISA pension plans have until September 9. As we phase in compliance with the recently completed cross-border interpretive guidance, collective investment vehicles, including hedge funds, whose principal place of business is in the U.S. but may have incorporated offshore (for instance, in the Cayman Islands) will have to comply with the clearing requirements by October 10. Further, guaranteed affiliates of U.S. persons will have to begin complying with the clearing requirement on October 10 as well. The CFTC also fulfilled Congress's direction to exempt nonfinancial end users from the clearing requirement.

Oversight of Swap Dealers and Other Intermediaries

The third critical piece of swaps market reform is oversight of swap dealers and investment funds operating in the swaps market. To extend the highway metaphor, we require that drivers have licenses and know the rules of the road. Though Congress did not suggest this for all market participants, they were clear that the dealers themselves had to be registered and be brought under new reforms. Furthermore, Congress directed that swaps reforms extend to investment vehicles that invest in swaps.

The foundational joint rules of the CFTC and SEC further defining swap dealers and swaps went into effect last October. By last December, swap dealers began to provisionally register. We now have had 80 swap dealers and two major swap participants provisionally register with the CFTC. This group includes the largest domestic and international financial institutions dealing in swaps, including the 16 institutions commonly referred to as the G16 dealers. We expect additional entities to register as swap dealers as the recently completed cross-border interpretive guidance becomes effective later this year.

Since the beginning of this year, swap dealers have had to report their trades to both regulators and the public. They also have had to comply with various business conduct standards that lower risk and increase market integrity. These include promoting the timely confirmation of trades and documentation of the trading relationship. Swap dealers also have been required since earlier this year to implement sales practice standards that prohibit fraud, require fair treatment of customers, and improve transparency.

Cross-Border Derivatives Reform

Congress was clear that the far-flung operations of U.S. enterprises are to be covered by reform. Recognizing the lessons of the crisis and modern finance, Congress was clear in section 722(d) of the Dodd-Frank Act that swaps reform does apply to activities outside our borders with "a direct and significant connection with activities in, or effect on, commerce of the United States."

The largest banks and institutions are global in nature, and when a run starts on any part of an overseas affiliate or branch of a modern financial institution, risk comes crashing right back to our shores. The nature of modern finance is that financial institutions commonly set up hundreds, or even thousands, of legal entities around the globe. In fact, the U.S.'s largest banks each have somewhere between 2,000 and 3,000 legal entities. AIG nearly brought down the U.S. economy because it guaranteed the losses of a Mayfair Branch operating under a French bank license in London. Lehman Brothers had 3,300 legal entities, including a London affiliate that was guaranteed here in the U.S., and it had 130,000 outstanding swap transactions. Citigroup had structured investment vehicles that were set up in the Cayman Islands, run out of London, and yet were central to not one, but two bailouts of that institution. Bear Stearns, in 2007 had two sinking hedge funds organized in the Cayman Islands that had to be bailed out by the parent entity. A decade earlier, the same was true for Long-Term Capital Management.

After receiving public input and coordinating with the SEC and other regulators, working with international regulators, we issued guidance and an exemptive order to provide clarity to the market that our new rules apply to cross-border derivative activities. The CFTC interprets the cross-border provisions to cover swaps between non-U.S. swap dealers and guaranteed affiliates of U.S. persons as well as swaps between two guaranteed affiliates. The guidance does recognize and embrace the concept of substituted compliances where there are comparable and comprehensive rules abroad. Further, the interpretive guidance captures offshore hedge funds and collective investment vehicles that have their principal place of business here in the U.S. or that are majority owned by U.S. persons.

We published the proposed guidance for public comment in June of last year and then sought additional comment in December. On July 12, we gave swap dealers organized in each of six jurisdictions (Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland) 5 additional months to come into compliance with certain swaps reforms as we assess the submissions from those jurisdictions regarding substituted compliance.

Investment Funds

Furthermore, Consistent with Congress's direction that swaps reforms extend to investment vehicles investing in swaps, the Commission approved final rules 18 months ago that increase transparency to regulators of commodity pool operators (CPOs) and commodity trading advisors (CTAs) acting in the derivatives marketplace—both futures and swaps. The rulemaking also rescinded prior exemptions from CPO registration that had been used by many hedge funds. As a result, CPOs of registered investment companies and hedge funds were required to register by December 31, 2012, and, to date, more than 500 funds and registered investment companies have done so. Pooled investment vehicles, including registered investment companies that trade more than a de minimis amount in commodities or market themselves as commodity funds now will be subject to CFTC oversight. These rules enhance transparency and increase customer protections through amendments to the compliance obligations for CPOs and CTAs. The Commission currently is considering staff recommendations to finalize a rule that seeks to harmonize with the securities laws, to the extent possible, requirements for CPOs of registered investment companies.

Looking Forward on Swaps Market Reform

Now that we have successfully completed the bulk of the rulemaking, and the market is largely implementing those reforms, the CFTC is focusing on three principal areas.

Compliance, Registration, Surveillance, and Enforcement

First, with most of the new reforms' compliance dates behind us, the CFTC is increasingly shifting toward reviewing registration applications of various entities and reviewing those entities and transactions for compliance through the agency's surveillance, examination, and enforcement functions.

The CFTC will continue to work with market participants as they phase in compliance with these completed reforms. The CFTC embraced phasing in compliance to smooth the transition to a new regulatory regime and to ensure that reform is actively implemented. Market participants began phasing in compliance last October. As I have reviewed, much already has been accomplished, but, looking ahead, there are critical compliance dates through the rest of this year and into 2014.

International Harmonization

Second, we are going to continue to work with regulators around the globe to promote reform and harmonize where we can. For example, we are working closely with our international counterparts to ensure that all U.S. persons and their guaranteed affiliates are covered by reform—either the Dodd-Frank Act reforms or through compliance with comparable and comprehensive rules of another jurisdiction.

Earlier this month, we took a significant step when the European Union and we announced a path forward regarding joint understandings for the regulation of cross-border derivatives. This was a significant step forward in harmonizing and giving clarity to the markets, particularly when there might be jurisdictional overlaps with regard to our respective reforms.

The CFTC over the next 5 months will be reviewing submissions from the six jurisdictions (Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland) to assess their regulatory regimes with regard to possible substituted compliance determinations.

We also are working with foreign regulators on memoranda of understanding to ensure that we will be able to exercise our respective supervisory responsibilities in an efficient, coordinated manner.

Dodd-Frank Rulemakings

Third, we do have a handful of rules to finalize, including capital and margin for swap dealers, the Volcker Rule and position limits.

The CFTC is collaborating closely domestically and internationally on a global approach to margin requirements for uncleared swaps. We have been working along with the Federal Reserve, the other U.S. banking regulators, the SEC and our international counterparts on a final set of standards to be published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO). The CFTC's proposed margin rules exclude nonfinancial end users from margin requirements for uncleared swaps. We have been advocating with global regulators for an approach consistent with that of the CFTC. I now anticipate that the final set of international standards, which are nearing completion, will not call for margin for nonsystemic, nonfinancial entities. After the international standards are published, the CFTC will further propose margin rules likely later this year and seek to finalize those rules in the first half of 2014.

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

In the Dodd-Frank Act, Congress directed the Commission to impose limits on speculative positions in physical commodity futures and options contracts and economically equivalent swaps. The agency finalized a rule in October 2011 that addressed Congress's direction to prevent any single trader from obtaining too large a share of the market to ensure that derivatives markets remain fair and competitive. Last fall, a Federal court vacated the rule, and we currently are in the process of appealing that decision. Concurrently, we are working on developing a new proposed rulemaking to address position limits. It is critically important that these position limits be established as Congress required.

Looking Forward on Other Critical Reforms

In addition to the ongoing work on swaps market reform, the CFTC also is pursuing a number of other critical initiatives. I will highlight three such initiatives in this testimony.

Customer Protection

First, the Commission is continuing its work to enhance the protection of customer funds in both the futures and swaps markets.

We have completed amendments to rule 1.25 regarding the investment of customer funds to benefit both futures and swaps customers in December 2011. The CFTC's gross margining rules for futures and swaps customers, which went into effect last November, require clearinghouses to collect margin on a gross basis. Futures Commission Merchants (FCMs) are no longer able to offset one customer's collateral against another or to send only the net to the clearinghouse. Swaps customers further benefit from the new so-called "LSOC" (legal segregation with operational comingling) rules, which also became effective last year and ensure funds are protected individually all the way to the clearinghouse.

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

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

The proposal includes a provision on residual interest to ensure that the assets of one customer are not used to cover the positions of another customer. We are considering the many comments we have received on this, consistent with the specific provisions of the Commodity Exchange Act and the overall goal of protecting customers. The Commissioners shortly will receive final staff recommendations on this rule. I think it is critical that we complete these reforms this fall.

Benchmark Interest Rates

Second, the CFTC is continuing its work with domestic and international regulators to ensure the market integrity of benchmark interest rates. Benchmark interest rates, such as the London Interbank Offered Rate (LIBOR) are very important to the American public. LIBOR is the reference rate for 70 percent of the U.S. futures market and more than half of our swaps market. It is the reference rate for more than $300 trillion in derivatives and more than $10 trillion in loans. We need to ensure that these benchmark interest rates have market integrity and that they are based on fact, not fiction.

The interbank unsecured market that the benchmarks are intended to measure, however, essentially no longer exists, particularly for longer tenors.

Furthermore, our enforcement actions against three global banks, along with those of the Financial Conduct Authority, the Justice Department and others, have shown that LIBOR, EURIBOR, and similar rates have been readily and pervasively rigged. The CFTC initiated an investigation in 2008 related to LIBOR. Barclays, UBS, and RBS paid fines of approximately $2.5 billion for manipulative conduct relating to these rates as a result of multiple agencies' enforcement and criminal actions.

Given these vulnerabilities and the real risk that they will remain, to ensure market integrity and support financial stability, the Financial Stability Oversight Council recommended in its annual report that U.S. regulators work with foreign regulators, international bodies, and market participants to promptly identify alternative interest rate benchmarks that are anchored in observable transactions and are supported by appropriate governance structures, and to develop a plan to accomplish a transition to new benchmarks while such alternative benchmarks are being identified. The Council further recommended that steps be taken to plan for and promote a smooth and orderly transition to alternative benchmarks, with consideration given to issues of stability and to mitigation of short-term market disruptions.

An IOSCO task force took an important step in bringing reform to benchmark interest rates in announcing new principles earlier this month. Given the known problems with LIBOR, EURIBOR, and other significant market benchmarks, I am pleased that the IOSCO Principles require that benchmarks be anchored by observable transactions and subject to robust governance processes that address potential conflicts of interest. This report establishes new international standards.

The Financial Stability Board (FSB) is building upon the work of IOSCO by initiating a review of alternatives to existing benchmark interest rates as well as considering any potential transition issues. The FSB has established an Official Sector Steering Group of regulators and central banks and will convene and guide the work of a Market Participants Group.

Direct Market Access

Third, Commission staff currently is developing a concept release for public comment concerning the testing of systems and supervision of market participants with direct electronic market access. These concepts will be designed to address potential risks that high frequency traders and others who have direct market access may cause. Working with other regulators, we hope to hear from the public on this issue soon.

Resources

Traffic laws are only as good and as valuable as the cops assigned to enforce them. While the reforms of the Dodd-Frank Act are essential to promoting transparency and lowering risk in the marketplace, they will not be sufficient to protect the public unless we have the cops on the beat to enforce them. To do so, the CFTC must be adequately funded.

The agency currently is operating on a budget of $195 million after sequestration and has a staff of 685. That is only 8 percent more staff than we had 20 years ago. Yet since that time, the futures market has grown five-fold, driven by rapid advances in technology. The swaps market is eight times larger than the futures market.

Imagine telling the South Dakota Highway Patrol or the Idaho Patrol that, instead of just patrolling the streets of South Dakota or Idaho, they are now responsible for policing a vast portion of the country's highway system, but they can only hire 8 percent more officers.

That is basically the challenge we now face at the CFTC. Making the challenge even harder is that the new highway system we have been tasked with overseeing is much more complex. Not only do we need resources to have enough cops on the beat, but we need to make sure that our cops have the tools necessary to police the highways and protect the public.

We are not asking for eight times our current funding, but investments in both technology and people are needed for effective oversight of these markets by regulators.

Though data has started to be reported to the public and to regulators, we need the staff and technology to access, review, and analyze the data. With 80 entities having registered as new swap dealers, as well as new swap data repositories, swap execution facilities, and clearinghouses, we need people to review registrations and to run examinations to ensure compliance and ensure market integrity. Furthermore, as market participants expand their technological sophistication, CFTC technology upgrades are critical for market surveillance and to enhance customer fund protection programs.

The U.S. Government is facing a strained budget environment, but adequately funding the CFTC is a good investment for the American public. The $182 billion AIG bailout was nearly 600 times more than the CFTC's budget request of $315 million. Without sufficient funding for the CFTC, the Nation cannot be assured that this agency can effectively enforce essential rules that promote transparency and lower risk to the economy. Without sufficient funding for the CFTC, the Nation cannot be assured this agency can closely monitor for the protection of customer funds and utilize our enforcement arm to its fullest potential to go after bad actors in the futures and swaps markets.

Conclusion

Today's hearing comes as many of the swaps market reforms that this Committee worked to include in the Dodd-Frank Act have already begun to benefit the American public. The CFTC, having completed 59 final rules, orders and guidances, has nearly completed the rule set, and market participants are coming into compliance with these reforms. Clearinghouses have begun clearing the majority of interest rate and credit index derivatives, and the biggest swap dealers have provisionally registered with the CFTC. The public and regulators are benefiting from transparency, as real time and regulatory reporting is already a reality. SEFs will be up and running soon.

Our staff has worked tirelessly to complete this reform that is so important to the American public. We will continue to work with domestic and international regulators on these critical reforms and to ensure compliance.

I am pleased to tell you that the swaps market, which once was an unregulated highway, now has streetlights and traffic laws. The dealers now have to have drivers' licenses. Though there is still critical work to be done, the swaps marketplace will no longer be dark and will now have safer roads. Still, our traffic laws will not be fully effective without a sufficient number of cops patrolling the highways and back roads.

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

CFTC Dodd-Frank Update

Final Rules, Exemptive Orders & Guidance

- Agricultural Commodity Definition
- Agricultural Swaps
- Anti-Manipulation
- Block Rule
- Business Affiliate Marketing and Disposal of Consumer Information
- Clearing Requirement Determinations
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Conforming Rules – Parts 1, 1.35, 3 and 4
- Cross-Border Exemptive Orders
- Cross-Border Application Guidance
- Derivatives Clearing Organization - General Provisions and Core Principles
- Designated Contract Markets – Core Principles
- Disruptive Trade Practices
- Dual and Multiple Associations
- End-User Exception
- Exemptive Orders – Effective Date for Swaps Regulation
- External Business Conduct Standards
- Foreign Boards of Trade - Registration
- Identify Theft (Jt. with SEC)
- Implementation Phasing for Clearing
- Inter-Affiliate Clearing for Financial Entities
- Internal Business Conduct Standards (Risk Management, Recordkeeping, & CCOs)
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Investment Advisor Reporting on Form PF (Jt. with SEC)
- Investment of Customer Funds (Regulation 1.25)
- Large Trader Reporting for Physical Commodity Swaps
- Position Limits for Futures and Swaps
- Privacy of Consumer Financial Information
- Process for "Made Available to Trade" Determinations
- Process for Review of Swaps for Mandatory Clearing
- Process for Rule Certifications for Registered Entities (Part 40)
- Real-Time Reporting for Swaps
- Registration of Intermediaries
- Removal of References to or Reliance on Credit Ratings
- Reporting Certain Post-Enactment Swap Transactions (IFR)
- Reporting of Historical Swaps
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions – Interpretive Guidance on "Actual Delivery"
- Retail Foreign Exchange Intermediaries – Regulations & Registration
- Retail Foreign Exchange Transactions – Conforming Amendments
- RTO/ISO Exemptive Relief
- Segregation for Cleared Swaps

CFTC Dodd-Frank Update

- Swap, Security-Based Swap, Security-Based Swap Agreement -- Further Definitions (Jt. with SEC)
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories – Core Principles, Duties & Registration
- Swap Data Repository Indemnification Interpretation
- Swap Dealers and Major Swap Participants - Registration
- Swap Dealers, Major Swap Participants, and Eligible Contract Participants - Further Definitions (Jt. with SEC)
- Swap Execution Facilities – Core Principles and Registration
- Whistleblowers
- 201(f) Exemptive Relief

Proposed Rules, Exemptive Orders & Guidance

- Capital for Swap Dealers & Major Swap Participants
- Clearing Exemption for Cooperatives
- Clerical and Ministerial Employees
- DCMs – Core Principle 9
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Margin for Uncleared Swaps
- Segregation for Uncleared Swaps
- Swap Dealer and Major Swap Participants – Clerical and Ministerial Employees
- Systemically Important Clearing Organizations – Additional Provisions
- Volcker Rule

Yet to be Proposed Rules & Guidance

- Stress Testing under Section 165

Other Final Orders

- Delegation to National Futures Association (NFA) – Certain exemptions for Commodity Pool Operators
- Delegation to NFA - Foreign Exchange Intermediary Registration function
- Delegation to NFA - Swap Dealer & MSP Registration function
- Treatment of Grandfather Relief Petitions - Exempt Boards of Trade & Exempt Commercial Markets
- Treatment of Grandfather Relief Petitions – Transactions done in Reliance on 2(h)

Studies & Reports

- Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives (Jt. with SEC)
- International Swap Regulation (Jt. with SEC)
- Risk Management Supervision of Designated Clearing Entities (Jt. With Board of Governors of the Federal Reserve System and the SEC)
- Study on Oversight of Carbon Markets (Jt. with various other Agencies)

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM MARY JO WHITE

Q.1. *Identifying New Systemic Risks*—What steps are the SEC and CFTC taking to identify other potential systemic risks in the markets each of you regulate?

A.1. Since the financial crisis, the SEC staff and their colleagues from other regulators have been collaborating with greater frequency and intensity to identify and appropriately address potential systemic risks. SEC staff participates in a number of working groups with other federal financial regulators relating to the supervision of certain large financial companies with subsidiaries or affiliates that are registered U.S. broker-dealers, where such risks may arise. In addition, SEC staff serves on the Financial Stability Oversight Council (FSOC or the Council) Systemic Risk Committee, which plays a role in monitoring systemic risk in the financial markets. As systemic risks often are global in nature, SEC staff also serves on international regulatory groups, such as Financial Stability Board committees, that seek to identify and develop coordinated initiatives to mitigate systemic risks, and I personally serve on the Financial Stability Board Steering Committee. These groups are designed to enhance regulatory cooperation and oversight, including crisis management and planning. Participation enhances the agency's ability to effectively supervise market participants by giving it greater insights into the full range of their activities, as well as providing a forum for regulators to discuss any emerging issues of potential concern with respect to those activities.

Commission staff also is active in (1) leading the regulatory oversight of four registered clearing agencies designated as systemically important by the FSOC for which we act as supervisory agency under Title VIII of the Dodd-Frank Act and (2) contributing to the oversight of two other clearing agencies for which the CFTC is the named supervisory agency. Among the activities undertaken in the past year are the examinations required by Title VIII, in which staff from the Federal Reserve Board participates, as well as ad hoc reviews by Commission supervisory staff focused on governance and risk management. These examinations and reviews include attention to a clearing agency's compliance processes; internal audit findings and resolution; board of directors' interaction; and risk management framework, including new product reviews and approvals, margin methodology, back-testing and stress-testing procedures, risk monitoring practices, model governance practices, and sizing and allocation of financial resources. Findings from such examinations and reviews are used by Commission staff both to define specific remediation actions, and to inform discussions of systemic risk issues more generally with the Federal Reserve Board and the CFTC, as well as with other financial regulators through the Financial Market Utilities Committee of the FSOC.

In addition, as a member of FSOC, I personally participate in the Council's work to identify risks to the financial stability of the United States and to respond to emerging threats to the stability of the U.S. financial system. As part of this work, particular emphasis is placed on identifying and follow-on monitoring of potential threats discussed in the FSOC's annual report, which most recently was published in April 2013 and is available at which most recently was published in April 2013 and is available at which most recently was published in April 2013 and is available at *http://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf*. Among other issues, that report discussed issues related to vulnerabilities to sudden spikes in fixed income yields, foreign economic and financial developments, and operational risk. These are issues the SEC staff continues to monitor both in conjunction with FSOC reviews and in our own oversight of the financial entities the SEC regulates.

Q.2. *CFTC–SEC Harmonization*—What are the differences between how your agencies plan to regulate cross-border swaps, and what steps are you taking to better harmonize the two approaches?

A.2. There are many similarities, as well as some differences, in how the SEC and CFTC plan to regulate cross-border swaps. Both agencies have proposed, and the CFTC has now adopted, a robust set of measures for regulating cross-border swap activity, including a "results-based" substituted compliance framework. The principal differences between the SEC's proposed cross-border approach and the CFTC's final guidance involve the scope of the term "U.S. person," the treatment of guaranteed affiliates, and the approach to substituted compliance for "true" cross-border transactions. In addition, the agencies' approaches differ in the application of margin requirements and, potentially, the application of the Dodd-Frank Act to conduct in the United States by counterparties booking transactions outside the United States.

First, with respect to the definition of "U.S. person," the SEC's proposed rules define the term in a more limited and territorial manner than the CFTC. A key difference is the CFTC's focus on foreign-organized investment vehicles, such as hedge funds, that are majority-owned by U.S. persons. The SEC did not propose to take into account majority-ownership in determining the U.S. person status of investment vehicles. Instead, the SEC's proposed definition focuses on the place of organization of those investment vehicles.

Second, unlike the CFTC's final guidance, the Commission's proposal does not require a non-U.S. person that receives a guarantee from a U.S. person to register as a security-based swap dealer so long as it limits its dealing activities to non-U.S. persons and conducts those activities outside the United States. Further, the Commission's proposal does not require a non-U.S. person that is not guaranteed by a U.S. person to register as a dealer if it limits its activities to non-U.S. persons, regardless of whether those non-U.S. persons receive a guarantee from a U.S. person. The Commission's proposal, however, does address these risks with more targeted regulatory measures to address the activities of guaranteed non-U.S. persons.

Third, the SEC's proposal would permit broad substituted compliance for "true" cross-border transactions, that is, those transactions involving a U.S. person and a non-U.S. counterparty (the so-called "New Jersey Transaction"). The CFTC's guidance limits the use of substituted compliance in these circumstances, but holds out the possibility of allowing compliance with foreign law in these circumstances if it determines that the foreign requirements are "essentially identical" to the requirements of the Dodd-Frank Act.

In addition, the SEC's proposal would treat margin as an "entity-level" requirement, requiring foreign dealers to collect margin from both non-U.S. and U.S. counterparties, whereas the CFTC's final guidance would not require foreign dealers to collect margin from non-U.S, counterparties. On conduct in the United States, the SEC's proposal would apply certain Title VII requirements to a transaction conducted in the United States, but booked outside of the United States. The CFTC's final guidance appears to focus on conduct in the United States solely in the context of dealing activity by a non-U.S. dealer through a U.S. branch.

As the SEC moves toward adoption of final cross-border rules, we are continuing to consider whether there are ways to bring our cross-border framework closer together with the CFTC framework. In addition to reviewing the comments we received on our proposal, we are carefully considering the approach taken by the CFTC in its final cross-border guidance. We are also engaging in discussions with CFTC on various cross-border issues with an eye toward finding ways, given the differences in our statutory frameworks, and in our products, markets and participants, to achieve more consistency at adoption.

Q.3. *Credit Rating Agencies*—What lessons have been learned in the credit rating market since the financial crisis? What has been learned considering the possible solutions, including the Franken Amendment? As the credit rating process is revised, do you think that the market can become less dependent on explicit ratings? Do you believe that the quality of ratings can improve?

A.3. The Credit Rating Agency Reform Act of 2006 provided the Commission with explicit oversight authority over credit rating agencies registered as nationally recognized statistical rating organizations, or NRSROs. This oversight authority was expanded with the enactment of the Dodd-Frank Act. Through the enhanced examinations of NRSROs that have been conducted since the financial crisis, as required by the Dodd-Frank Act and documented in our annual reports to Congress, we have seen the NRSROs strengthen their governance structure and their controls, increase transparency, and enhance the integrity of the ratings process. Other important issues have been addressed in a suite of recent Commission studies on credit rating standardization, reliance on credit ratings, and assigned credit ratings.

The staff also is working to finalize the suite of new rules required under the Dodd-Frank Act that are applicable to NRSROs, and the Commission continues to focus on removing references to credit ratings in its rules and regulations. We expect that both of these efforts will contribute significantly to industry reform. Pursuant to the authority provided to the Commission under the Dodd-Frank Act, the staff will continue to examine the NRSROs' compliance with applicable rules and may develop further recommendations to be presented to the Commission in the future.

In particular, in December 2012, Commission staff issued a *Report to Congress on Assigned Credit Ratings,* as required by Section 939F of the Dodd-Frank Act. The staff recommended that the Commission, as a next step, convene a roundtable to discuss the potential courses of action presented in the report. The Commission held this Credit Ratings Roundtable in May 2013 with broad representation from a range of interested constituencies. The staff considered the various viewpoints presented during discussion at the roundtable, as well as in the related public comment letters, and will be presenting to the Commission a recommendation for its consideration. Any such staff recommendation will be designed to increase transparency, foster competition, mitigate conflicts of interest associated with the issuer-pay business model, and may consider removing certain impediments in the rules to encourage the issuance of unsolicited credit ratings for structured finance products.

In terms of whether the market can become less dependent on ratings, increased transparency with respect to credit ratings and the credit ratings process is designed to promote less mechanistic reliance on credit ratings. The Commission's continued focus on removing references to credit ratings in its rules and regulations will further the efforts to reduce market dependence on ratings.

The notion of quality of ratings would include integrity in the ratings process, governance and controls around determining and disseminating ratings, and ongoing surveillance of ratings. Consistent with the authority provided to the Commission, the staff's examinations are designed to test, assess and, where deficient, make recommendations for improving, the ratings process. This oversight should ultimately lead to improvement in the quality of ratings. It is important to note, however, that quality of ratings is distinct from accuracy of ratings. Market participants need to judge for themselves the quality of ratings and whether to use those ratings as an input in their decision making.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM MARY JO WHITE

Q.1. By regulations enacted in December 2011, both the SEC and CFTC collect information on private funds (hedge funds, private equity, and liquidity funds). The SEC has been collecting data on Form PF for over a year, and the CFTC on its Form PQR more recently (starting with March 31, 2013, data). What plans does your agency have for the review and use of this data?

A.1. While data collected on Form PF is intended primarily for use by the Financial Stability Oversight Council's (FSOC) in monitoring systemic risk, the Commission also may use the information collected on Form PF in its regulatory programs, including examinations, investigations, and investor protection efforts relating to private fund advisers. As detailed in an annual report provided to Congress on July 25, 2013, Commission staff has begun to assess the quality of the Form PF data collected, including evaluating the consistency of filer responses and differences in approaches or assumptions made by filers. Commission staff has established a working group with the Office of Financial Research—the group within the Department of Treasury responsible for performing FSOC's systemic risk analyses—to coordinate how potential data quality concerns are addressed. In addition, a number of uses of the information have been identified across various Commission Divisions and Offices. For example, Commission staff has incorporated Form PF data into proprietary analytical tools and will develop data analytics incorporating Form PF data. Also, Commission staff anticipates using the information collected on Form PF as part of their pre-examination due diligence and in risk identification.

Q.2. The SEC is on a good trajectory toward embracing economic analysis. While I applaud its achievements, there is more to be done and it is too early to declare victory. Chair White, do you remain committed to complete implementation of the Commission's economic guidance?

A.2. I continue to believe that robust and transparent economic analysis is key to developing strong and effective regulations. The 2012 *Current Guidance on Economic Analysis in SEC Rulemaking* has enhanced the economic analysis in rulemaking at the Commission, and I remain committed to its ongoing application. Indeed, I am always seeking ways to further improve our consideration of the potential economic impacts of Commission rules and will continue those efforts.

Q.3. The SEC's Money Market Fund rulemaking proposes to float the NAV for prime institutional funds. I have concerns regarding the interaction of tax issues and the proposal. Chair White, in addition to considering the IRS's guidance on wash sales, is the SEC coordinating with the IRS to address tax issues associated with a potential floating NAV?

A.3. Commission staff is engaged in dialogue with staff at the Internal Revenue Service and the U.S. Department of the Treasury about the tax implications associated with a floating NAV reform alternative, as well as administrative relief that the IRS and Treasury Department are currently considering that could reduce tax reporting-related burdens and costs to shareholders. The reporting relief that Commission staff understands the IRS and Treasury Department are considering would allow for net information reporting by funds of realized gains and losses for sales of fund shares, as well as summary income tax reporting by shareholders (rather than requiring funds and shareholders to report the details of each transaction separately). In addition, Commission staff is working with staff at the IRS and Treasury Department to address issues relating to "wash sale" rules that apply when shareholders sell securities at a loss and, within 30 days before or after the sale, buy substantially identical securities. As you note, the IRS recently proposed guidance on the wash sale rules, under which redemptions of floating NAV money market fund shares that generate losses below a certain threshold would not be subject to these rules. The June 2013 money market fund reform proposal describes the tax implications relating to the floating NAV alternative generally, as well as potential IRS and Treasury Department relief that would affect these implications. I, along with Commission staff, currently are reviewing comment letters submitted in response to the proposal, including comments requesting that greater tax relief be provided in connection with any floating NAV requirement in order to minimize operational burdens on fund groups and their intermediaries and shareholders. These comments certainly will inform any money market fund reforms that the Commission ultimately adopts, and I have directed SEC staff to continue working with the IRS and Treasury Department to minimize any tax-related burdens associated with money market fund reforms to the maximum extent possible.

Q.4. Chairman Gensler suggested in his hearing testimony that the CFTC and SEC coordinated closely in the issuance of the CFTC's final cross-border guidance and exemptive order. What is your view regarding the extent to which SEC's comments are incorporated into the CFTC's final guidance? Do you think that more could have been done to move the CFTC's and SEC's framework closer together?

A.4. The Dodd-Frank Act requires the SEC and CFTC to consult and coordinate regularly for the purposes of assuring regulatory consistency and comparability, to the extent possible. To that end, SEC and CFTC staff exchanged draft documents relating to our respective cross-border efforts, and engaged in conversations on various cross-border issues, over the months leading up to the issuance of our cross-border proposal and the CFTC's final guidance. These efforts helped us better understand the CFTC's thinking on various cross-border issues, and, similarly, we believe they helped shape the CFTC guidance in some respects. For example, the CFTC's final guidance addresses foreign banks conducting dealing activity out of their U.S. branches with foreign customers, an issue that was not addressed in the CFTC's proposed guidance, but was addressed in the SEC's cross-border proposal.

I believe there is much that can and should be done going forward to ensure close consultation and collaboration on regulatory and interpretive questions affecting these markets that the two agencies jointly regulate, and our staff has continued to engage in useful and productive discussions with CFTC staff in that regard. In addition, as I indicated at the hearing, I am committed to having discussions at the principal level to enhance coordination with the CFTC on cross-border issues.

Q.5. As you know, the FSOC is responsible for the designation of nonbank systemically important financial institutions (SIFIs), and has publicly indicated that it is reviewing what risk, if any, asset managers pose to the U.S. financial system. The SEC is the expert agency on asset management, both from its long-established oversight of the mutual fund industry. What role is the SEC playing in this FSOC review? Is the SEC's expertise being reflected in the study?

A.5. I agree that, as the primary regulator of the asset management industry, the SEC possesses unique expertise in this area. I directed relevant SEC staff to engage with the Office of Financial Research (OFR) in the preparation of its study and to provide our staff's input. Ultimately, however, the study is the work product of the OFR. The OFR published this study in September 2013, and the SEC has invited public feedback on the study (see, *http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539852635*). We have received approximately 25 letters in response to this invitation for public feedback. In addition, I would expect that the SEC, as the primary regulator of the asset management industry, would be involved in any follow-on work as a result of the study.

Q.6. The Federal Reserve currently has under consideration a proposal that would require foreign banks to hold their U.S. broker-dealer operations through a U.S. intermediate holding company. Concerns have been expressed regarding the impact the application of bank capital rules at that holding company level—especially the leverage requirement—would have on the broker-dealer. Is the SEC concerned about the implications of the Fed's proposal for broker-dealers, and is the SEC working with the Fed to address them?

A.6. The SEC has a net capital rule for broker-dealers that is designed to ensure that customers and other market participants are fully protected in the event a broker-dealer fails by requiring a broker-dealer to hold an amount of liquid assets that is greater than its liabilities. The rule and related financial responsibility requirements are aimed at both protecting customer assets and limiting damage to the financial system that may result from the failure of a broker-dealer.

Aspects of the Fed's proposal, particularly the bank leverage requirements, potentially could affect the operations of certain broker-dealers by, for example, requiring the allocation of additional capital to the broker-dealer. Such a result could in turn limit the ability of the broker-dealer to engage in some businesses, including by increasing the financing costs associated with a repurchase agreement or securities lending activities.

The Commission staff is focused on these potential effects and is continuing to consult with Federal Reserve staff to fully define their extent and consequences, identify any potential changes to the proposal that may be appropriate, and help ensure that the impact on broker-dealers is fully considered and factored into adoption of any final rules in this area.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORKER FROM MARY JO WHITE

Q.1. I know there is discussion around having the SEC pick a rating agency for every deal that gets done. While I support increased regulation of the use of these ratings and the rating agencies themselves, I have to say that instituting a mandatory rotation rule managed by the SEC seems like a cumbersome way to solve a problem. Is having the SEC play the role of selecting the rating agency on every deal even logistically possible? I understand that reforms to the way in which we use ratings is warranted, and I know that we have made some reforms already, such as not allowing ratings to be used by regulators as the primary tool for assessing a bank's asset quality. But forcing the SEC to assign a rating agency to every deal seems like overkill. Where do we stand with that issue?

A.1. As you know, in December 2012, Commission staff issued a *Report to Congress on Assigned Credit Ratings,* as required by Section 939F of the Dodd-Frank Act. The staff recommended that the Commission, as a next step, convene a roundtable to discuss the potential courses of action presented in the report. The Commission held this Credit Ratings Roundtable in May 2013 with broad representation from a range of interested constituencies.

The staff considered the various viewpoints presented during discussion at the roundtable, as well as in the related public comment letters, and will be presenting to the Commission a recommendation for its consideration. Any such staff recommendation will be designed to increase transparency, foster competition, mitigate conflicts of interest associated with the issuer-pay business model, and may consider removing certain impediments in the rules to encourage the issuance of unsolicited credit ratings for structured finance products. Any reforms considered also will be focused on efficient, noncumbersome solutions.

The staff is also working to finalize the suite of new rules required under the Dodd-Frank Act that are applicable to nationally recognized statistical rating organizations, or NRSROs, and the Commission continues to focus on removing references to credit ratings in its rules and regulations. We expect that both of these efforts will contribute significantly to industry reform. Pursuant to the authority provided to the Commission under the Dodd-Frank Act, the staff will continue to examine the NRSROs' compliance with applicable rules and may develop further recommendations to be presented to the Commission in the future.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR JOHANNS FROM MARY JO WHITE

Q.1. I understand this hearing is about systemic risk and that has been the focus of Congress and the regulators for the last 5 years. However, in focusing so much time and resources on systemic risk, is it possible we are hindering innovation and opportunities for investors? I am aware of hundreds of ETF applications and innovations that have been pending at the SEC for years—some as many as 5 years. Very few businesses can wait for Government approvals for 5 years.

Press reports indicate that the Division of Investment Management (DIM) is considering streamlining the ETF approval process. Is this accurate?

Can you tell me the timeline for when we should see something on this from DIM, and what you expect the parameters to be for streamlined review? Is it your expectation that all equity ETFs with no leverage and no synthetic instruments will be eligible for this streamlined approval process?

A.1. Prior to offering any securities to the public, Exchange Traded Funds (ETFs) seeking to operate as investment companies under the Investment Company Act of 1940 must receive exemptive relief from various provisions of that Act. In order to receive the Commission's exemptive relief, an ETF must be listed and traded on a national securities exchange, and an ETF must be able to meet the requirements for listing standards prior to being listed and traded on a national securities exchange.

The Commission's Division of Investment Management has significantly streamlined its internal review process for ETF applications. It has instituted deadlines for the staff's review and developed generally standardized terms and conditions for these applications. In addition, the staff redesigned the Commission's Web site so that "model" ETF applications are now easily available to applicants for review and guidance, a step that has been applauded by the industry. Applicants that use these models for "plain vanilla" ETFs—i.e., ETFs that seek to achieve the performance of a securities-based index or ETFs whose investment advisers actively manage fund investments, including synthetic instruments, to achieve a stated investment objective—receive expedited treatment of their applications.

In order for a national securities exchange to list the shares of an ETF for trading, the ETF must either fit within the exchange's existing "generic" listing standards, which have been approved by the Commission and require no further regulatory action, or the exchange must file a proposed rule change with the Commission pursuant to the Exchange Act to list and trade the new ETF, which the Commission must approve before the exchange can list or trade the ETF. The Exchange Act sets out the timing for Commission review of—and action on—the proposed rule changes. If the Commission fails to meet any of the statutory deadlines, the exchange's filing is deemed approved. The exchange makes the decision as to when to file its proposal and thereby trigger the statutory time frames.

Staff in the Commission's Division of Trading and Markets, which oversees proposed rules changes and other requests for relief relating to the listing and trading of all exchange-traded investment products (ETPs), including ETFs, on national securities exchanges, has been evaluating market issues relating to the listing and trading of ETPs on national securities exchanges.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM GARY GENSLER

Q.1. *CFTC–SEC Harmonization*—What are the differences between how your agencies plan to regulate cross-border swaps, and what steps are you taking to better harmonize the two approaches?

A.1. The staffs of the CFTC and SEC have closely consulted in an effort to increase understanding of each other's regulatory approaches and to harmonize the cross-border approaches of the two agencies to the greatest extent possible, consistent with their respective statutory mandates. The Commissions recognize the value of harmonizing their cross-border policies to the fullest extent possible. The staffs of the two Commissions have participated in numerous meetings to work jointly toward this objective. The Commissions expect that this consultative process will continue as each agency works towards implementing its respective cross-border policy.

Two months before publication of the CFTC's cross-border guidance, the SEC published for public comment proposed rules and interpretive guidance to address the application of the provisions of the Commodity Exchange Act, added by Subtitle B of Title VII of the Dodd-Frank Act, that relate to cross-border security-based swap activities. The CFTC considered the SEC's cross-border proposal and took it into account in the process of preparing the CFTC's final interpretive guidance.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM GARY GENSLER

Q.1. By regulations enacted in December 2011, both the SEC and CFTC collect information on private funds (hedge funds, private equity, and liquidity funds). The SEC has been collecting data on Form PF for over a year, and the CFTC on its Form PQR more recently (starting with March 31, 2013, data). What plans does your agency have for the review and use of this data?

A.1. The data will be used to check disclosures that are made to commodity pool participants and to assist in the review of annual financial statements and footnote disclosures. The data also will be used to support examinations of futures commission merchants (FCMs), including for assessing contagion pathways in the event of a failure of either an FCM or a commodity pool.

Q.2. The CFTC's cross-border guidance was done outside the formal notice and comment process that the Administrative Procedure Act provides. Therefore, there was no opportunity for the public and stakeholders to formally comment on the final guidance prior to its release. Chairman Gensler, given the global significance of the cross-border issue, please explain why you found it acceptable to proceed without transparent formal notice and comment rulemaking?

A.2. Congress was clear that the far-flung operations of U.S. enterprises are to be covered by reform. Recognizing the lessons of the crisis and modern finance, Congress provided in section 722(d) of the Dodd-Frank Act that swaps reform applies to activities outside our borders with "a direct and significant connection with activities in, or effect on, commerce of the United States." To respond to industry questions regarding the interpretation of that provision, the Commission on June 29, 2012, voted to propose for public comment interpretive guidance on the manner in which it would apply Title VII's swaps provisions to cross-border activities.

The CFTC received approximately 290 comment letters on the proposed guidance from a variety of interested parties, including major U.S. and non-U.S. banks and financial institutions that conduct global swap business, trade associations, clearing organizations, law firms, Congressional offices, public interest organizations, and foreign regulators. While considering the proposed guidance, including the public comments, the CFTC determined that further consideration of public comments regarding the CFTC's proposed interpretation of the term "U.S. person," and its proposed guidance regarding aggregation for purposes of swap dealer registration would be helpful. On January 7, 2013, the CFTC published further proposed guidance on these points. The CFTC received approximately 24 comment letters on the further proposed guidance. The CFTC's final cross-border guidance discusses the significant issues raised by the commenters on the proposed guidance, and how the CFTC addressed the points that they made.

In addition to these comment letters, Commission personnel held over 50 meetings regarding cross-border issues with various market participants and others with an interest in the guidance. The CFTC consulted closely throughout the process with the SEC, other U.S. regulators, and international regulators in developing the cross-border guidance.

The comment letters, meetings, and other information provided were crucial to the Commission's effort in finalizing the interpretive guidance.

Q.3. The CFTC does not yet have a permanent Chief Economist. This is a critical role to be filled in order for the CFTC to understand the economic consequences of the regulatory choices it makes.

Chairman Gensler, what is the status of the CFTC's search for a permanent Chief Economist?

A.3. The Commission continues in its efforts to appoint a permanent Chief Economist. Scott Mixon currently serves as Acting Chief Economist. Dr. Mixon is a financial economist with over 15 years of industry experience implementing and communicating quantitative and empirical analysis.

OCE staff economists play an integral role in cost and benefit considerations, as well as other aspects of agency rulemakings. OCE staff consists of both Ph.D. and pre-Ph.D. economists trained in conducting policy analysis, economic research, expert testimony, education, and training.

Q.4. While the CFTC and SEC coordinated private fund reporting in principle, the CFTC is now requiring those private funds that report on Form PF to also file certain information on the CFTC's Form PQR. Both forms differ in how the same data is presented and filed with the agencies (e.g, list of investments)—this means that OFR is not receiving comparable information. This is an unnecessary burden on industry. Are you aware of this disconnect? What can the CFTC do to provide consistency here?

A.4. Dually registered investment advisers to private funds that file Form PF only have to file Schedule A of Form CPO–PQR with the Commission. This information is largely demographic in nature and represents a small subset of the solicited data. With respect to the schedule of investments, for example, the adviser to the private fund would only report that information on Form PF. With respect to the information that OFR is receiving from the SEC and CFTC, OFR will not receive duplicative or inconsistent data as a result of these advisers filing Form PF and Schedule A of Form CPO–PQR.

Q.5. Based on statements of CFTC Commissioners, we understand transmitting swaps data that is collected in swap data repositories (SDR) to the CFTC has caused the CFTC's computers to crash. The CFTC is also collecting private fund reporting data, which is information is filed through the National Futures Association (NFA) system and then transmitted to the CFTC. Please explain the technological problems the CFTC has encountered in the transmission of the SDR and NFA data to the CFTC system.

A.5. The Commission currently receives and processes more than half a billion rows of data every day from regulated entities and has the capability to use SDR-provided facilities to access swaps reporting data and receives sub-sets of that information as necessary. An instance when CFTC personnel attempted to open a very large file from an SDR with malformed data caused a temporary disruption. The SDR corrected the data and the problem was resolved.

United States Conference of Mayors
81st Annual Meeting
June 21-24, 2013

EXPRESSING OPPOSITION TO THE SECURITIES AND EXCHANGE COMMISSION PROPOSED CHANGES IN NET ASSET VALUE RULES FOR MONEY MARKET MUTUAL FUNDS

WHEREAS, the Securities and Exchange Commission has proposed additional changes to SEC Rule 2a-7 above and beyond the comprehensive amendments adopted in January 2010 to strengthen money market funds and ensure investors are investing in high-quality securities; and

WHEREAS, because of the enhanced liquidity and transparence fostered by the comprehensive amendments adopted in 2010, these changes appear to have help MMMFs endure recent periods of market turbulence without incident or systemic risk; and

WHEREAS, while state and local governments are supportive of changes that will strengthen the market and improve the quality of securities, some of the additional changes being discussed would undermine the value and utility of Money Market Mutual Funds as well as the municipal bond market; and

WHEREAS, one of the modifications being discussed is changing the stable net asset value (NAV), which is the hallmark of money market mutual funds (MMMF), to a floating net asset value that would be very harmful to state and local governments; and

WHEREAS, forcing funds to float their value would likely eliminate the market for those products by forcing investors, including state and local governments, to divest their MMMF holdings as well as discourage others from using these funds; and

WHEREAS, many state and local governments look to MMMF as an integral part of their cash management practice because they are highly regulated, have minimal risk and are easily booked; and

WHEREAS, in the fourth quarter of 2012, state and local governments held $119 billion in MMMFs; and

WHEREAS, many state and local governments have specific policies or statutes that mandate investing in financial products with stable values, and MMMFs are the investment they use to ensure compliance with these policies and statutes; and

WHEREAS, MMMFs are also related to the municipal bond market in that in the fourth quarter of 2012 they were the largest investor in short-term municipal bonds (with $322 billion in short-term municipal debt securities, which accounts for 76% all outstanding short-term municipal debt),

WHEREAS, changing net asset value from fixed to floating would make MMMFs far less attractive to investors and have an extremely disruptive effect on the investing market as well as the municipal bond market, which could ultimately cost state and local governments millions of more dollars as the would be forced to turn to more costly – and/or more risky – investments as well as face higher costs for issuing debt due to shrinking demand for the market, and

NOW THEREFORE BE IT RESOLVED, that The United States Conference of Mayors strongly urges the Securities and Exchange Commission not to make changes to the NAV or any further regulatory changes that would disrupt the existing structure of and characteristics of MMMFs and limit choices for state and local governments businesses and other investors, with far reaching consequences for the American economy.

Projected Cost: Unknown

RESOLUTION ADOPTED JUNE 2013