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PARTICIPANTS:

Chairman Schapiro

Chairman Gensler

Commissioner Casey

Commissioner Walter

Commissioner Aguilar

Commissioner Paredes

Commissioner Dunn

Commissioner Sommers

Commissioner Chilton

Panel One -- Enforcement

Daniel Roth, National Futures Association

David Downey, OneChicago

Kenneth Raisler, Sullivan & Cromwell

William R. McLucas, Wilmer Cutler Pickering Hale and Dorr

Damon Silvers, AFL-CIO

Richard Owens, Latham & Watkins

Professor John Coffee, Columbia Law School

Panel Two -- Investment Funds

Richard Baker, Managed Fund Association

Sharon Brown-Hruska, NERA Economic Consulting

Kathleen Moriarty, Katten Muchin Rosenman

Michael Butowsky, Mayer Brown

Michael Connolly, Association of Financial Professionals

P R O C E E D I N G S

CHAIRMAN SCHAPIRO: Good morning. Welcome to the second day of the SEC and CFTC's Joint Meetings on Harmonization of Market Regulation. We're very pleased to welcome everybody to the SEC's headquarters, and I am of course extremely pleased to be again joined by Chairman Gensler and my fellow commissioners from the SEC and the CFTC.

I want to take this opportunity to thank our distinguished panelists who are with us today to share their insights, advice and recommendations on many important topics. And I also want to thank again the staffs of the SEC and the CFTC for your extraordinary work in organizing these joint meetings.

Yesterday during our first day of the joint hearings, we heard from three separate panels that discussed a broad range of issues, including the regulation of exchanges and markets, clearance and settlement, margin requirements and the regulation of intermediaries.

Chairman Gensler is going to highlight for us in a moment a number of the areas of particular focus. I would note that we had very good debate and discussion I think in particular on the product approval process at both of the agencies, the need for international coordination, margin issues and portfolio margining in particular, the one-pot, two-pot debate, and insider trading as well. So I'm looking forward to some more discussion on those issues today, and of course on a host of new issues.

So today we will continue the discussion of harmonization with a panel on enforcement and investors rights and remedies, followed by a panel that will focus on the regulation of pooled investment vehicles. Again, public input will help inform both agencies on where harmonization may be needed and how it may be achieved, where potential gaps exist and how they should be addressed, and where there may be potential overlap.

I am confident that the insight we gained from yesterday's discussion and will gain from today's discussion will help the SEC and CFTC make progress on the goals expressed in the Administration's whitepaper as we seek to build a common framework for market regulation.

I would like again to welcome and thank our distinguished panelists for their participation and contributions to our efforts. The insights that you provide today will be extremely valuable to us as we go forward in this initiative, and with that, let me turn it over to Chairman Gensler.

CHAIRMAN GENSLER: Thank you, Chairman Schapiro, my fellow commissioners, members of the Securities and Exchange Commission, and thank you our distinguished panelists. It's good to be here at the SEC and working cooperatively in the best interest to serve the public. It's also particularly interesting to me as we seek to harmonize our rules to see this wonderful hearing room, to know that the SEC is directly next to Union Station as I commute from Baltimore, and to see that the press has a press box just like at a ball game. So maybe there's some things we can learn from the SEC.

In our first day of hearings, Chairman Schapiro said we heard from experts and we've gained valuable insights as to where the CFTC and the SEC could better promote market integrity, transparency, prosecute fraud, manipulation and other abuses through greater consistency in our regulations.

I believe the three broad areas where the CFTC and SEC must work to enhance our regulatory structures, to close gaps as we are currently doing with Congress to address over-the-counter derivatives, to look to see where we have overlaps and make sure that we not allow for regulatory arbitrage in those overlaps, and certainly where we address ourselves to similar products, similar intermediaries, similar markets, that we find greater consistency where appropriate.

Participant testimony yesterday and reading the testimony today did highlight a number of areas, and at the end of yesterday's hearing, I summarized those, and Commissioner Casey said it was helpful, so I thought I'd just summarize them once again here. But are things that we thought would be helpful jointly just to hear from you all on, and I'll just mention them quickly.

But one is product listing, the self-certification of prior approval.

Two is exchange and clearinghouse rules, again, self-certification or prior approval and how that moves forward. Risk-based or portfolio margining with cross-margining of futures and securities products together.

The fungibility and competition among execution platforms. Again, it's related to clearing, but competition and exchange platforms.

Uniform customer account in bankruptcy and insolvency regimes. The benefit the public could gain possibly from that.

There was a broad discussion about market structure, separate versus linked markets and so forth and related issues about market surveillance.

Standards for prosecuting market manipulation, which I know this panel is going to help us a lot on.

Questions about how we punish and should we punish insider trading in the derivatives market and particularly in the commodities markets.

Customer protection issues. Suitability versus disclosure regimes and so forth. Customer protection issues with regard to fiduciary obligations, not only in brokers and intermediaries but over in our world in CTAs.

Mutual recognition, international cooperation and so forth.

And twelfth, the use of principles-based for exchange and clearinghouse oversight versus rules-based. So if that's not enough to chew on. But it was just a summary of some of the key things that came up yesterday.

I look forward to hearing from each of the panelists. I know this is going to be a full day as well. I take very serious President Obama's call to harmonize regulations in the futures and securities markets. And as we discuss these issues today, I'd like to reaffirm that we should I believe have no sacred cows, that it's important that we at the CFTC and the staff all check turf at the door and really say what's best for the American public, what's best for markets to promote integrity and efficiency and protect the investor public.

And with that, I thank the chair for inviting us all here today, and I turn it back. You can introduce the panelists.

CHAIRMAN SCHAPIRO: Let me very quickly introduce our panelists. Immediately to my left is Dan Roth from the National Futures Association and David Downey from OneChicago. Ken Raisler, Sullivan & Cromwell. Bill McLucas from Wilmer Cutler Pickering Hale and Dorr. Damon Silvers from AFL-CIO. Richard Owens from Latham & Watkins, and Professor John Coffee from Columbia Law School. And why don't we do opening statements in that order. So if you'll start, Dan, that would be great.

MR. ROTH: Thank you, Chairman Schapiro and Chairman Gensler and all the commissioners for the opportunity to be part of this enforcement panel and to really talk about how issues regarding overlapping jurisdiction and gaps in regulatory jurisdiction and inconsistencies affect the enforcement issues that we deal with at NFA.

For a self-regulatory body like NFA, overlapping jurisdiction is a fact of life that you deal with every day. Our jurisdiction always overlaps that of the CFTC's. It frequently overlaps with the exchanges and with FINRA and with the SEC. And in our experience, the overlap in jurisdiction has both an up side and a down side. And the upside is simply that it actually strengthens customer protection in a lot of instances.

At NFA one of the most powerful tools that we have is what we call a member responsibility action, which is an emergency action we take to prevent ongoing fraud. And it's a very powerful tool. But it has limited reach. Because we're a membership organization, we can only freeze assets that are held by NFA members, and sometimes that's just not going to get the job done.

And so very often when we issue these member responsibility actions, we're just trying to hold down the fort until the government can come into court and achieve more sweeping protection, and that's what happens. We had 22 instances in the last two years where an NFA member responsibility action led to very prompt CFTC action to obtain a wider freeze of customer assets, and five different instances where it was the SEC that came to court and achieved that broader customer protection.

So actually I think overlapping jurisdiction can really help in the case of customer protection. The down side of course, is if we waste precious resources by duplicating each other's efforts, and you just try to avoid that. I know at NFA we meet on a quarterly basis with the Division of Enforcement, and they're all-day meetings. But we make sure that they know every single case that we're working on to try to avoid that kind of duplication. And although we've worked well in that area, I'm sure that at NFA and with all the regulators, there's more that we can do and should do to avoid that kind of duplication.

But overall, from a customer protection point of view, overlapping jurisdiction is not a problem. Gaps in regulatory jurisdiction, that's a problem, and that's a real problem. And I discuss it in my written testimony and go over some of the history of the problems that we've had specifically in the area of retail forex.

Let me just say this with respect to those gaps. We were very pleased that the Treasury Department's proposed legislation included language that we've been advocating for a long time to try to make sure that for products other than foreign currencies, that anyone that's offering retail customers a futures contract or a futures look-alike contract, would be required to do that on exchange in a regulated transparent environment. We think that's a really good idea. We're very pleased to see that. We hope that goes forward.

With respect to forex products, we were very pleased that in May of 2008, Congress clarified that the CFTC has anti-fraud authority to go after people that sell these futures look-alike products to retail customers. And that's good. That's better than where we were before that, but it's not enough. And we look forward very much to working with the commissions and with Congress to try to achieve some better results in that area.

So regulatory gaps are a problem. The ones we've been dealing with mostly at NFA involve the retail forex and the other related types of instruments. And we've made some progress, but there's more to do.

With respect to inconsistencies, I know that there were a couple of times yesterday when suitability was mentioned. And let me make two points, if I could. Number one, our rule at NFA is different than the rule in the securities industry for the simple reason that the products that our members offer to the public are different. When we were writing this rule a long time ago, but my memory is not so bad that I don't remember it, when we were writing this rule, we could not envision a situation in which it would be -- a member could make a suitable recommendation that a customer trade in heating oil futures but somehow trading in interest rate futures would not be a suitable recommendation. The fact is that all of these products are risky. And in our view, the determination, the suitability determination, had to be made on a customer-by-customer basis rather than trade-by-trade, and that's what our rule requires. It requires that members have an affirmative duty to get information about their customers and then to tell some customers that futures trading is just too risky.

The final point I'd make is that if you're going to really evaluate the effectiveness of any customer protection regime, it's not enough just to read the rule book. At some point, you've got to look at results. And the fact is that we drafted this rule and implemented it very early on in NFA's life, and since NFA began operations, volume on the futures exchanges in the U.S. has gone up by over 2,000 percent, and over that same period of time, customer complaints have actually gone down by 75 percent.

So I think that has some relevance. I think our experience, I think our rule is tailored to the needs of the futures industry. I think the results indicate that we've taken the right approach, that the drop in customer complaints was the result of a lot of hard work by the CFTC and NFA, and we look forward to answering your questions.

CHAIRMAN SCHAPIRO: Thank you. David.

MR. DOWNEY: My name is David Downey. I am not an enforcement person. I run a trading exchange. I'm chief executive officer of OneChicago. OneChicago is the regulated exchange in the United States for trading in security futures on individual equities, ETFs and narrow-based indexes. Security futures have features that allow equity positions to be carried on much more favorable financing terms than borrowing from brokers and margin accounts and paying the associated interest expense, as well as allowing those customers to synthetically participate in the incredibly profitable, and as of today, nontransparent, OTC world of securities lending.

It is my honor to represent the exchange at this forum, sharing the table with such a distinguished panel. OneChicago is owned by the Interactive Brokers Exchange

Group, the CME group and the Chicago Board Options Exchange. Our transactions are cleared by the Options Clearing Corporation as well as the CME clearing division. We are regulated by both the SEC and the CFTC. Our member firms are broker-dealers as well as FCMs.

Being at the epicenter of these varied organizations criss-crossing paths has subjected me to discussions on many of the topics discussed here today, and I would like to give some personal views on them. Then I will briefly describe our experience with having both the SEC and the CFTC as regulators working together.

Competition. There needs to be a national clearing and settlement system for futures in America that is nondiscriminatory for qualified organizations to join, along the lines of the Options Clearing Corporation. This will allow for competition which would breed innovation as different organizations would compete to offer the fastest access through the best prices at the lowest cost.

Portfolio margining. Efficient use of capital should be encouraged and artificial barriers should be removed. Towards that end, true risk-based margin, portfolio margining, should be championed. The current impasse on whether futures can be placed in the same account as securities needs to be broken, but that won’t be easy. There is just too much money involved. The collateral put up to defend positions is used to generate income for the holder. Changing where those positions reside will change who holds the collateral and us who makes the money. CFTC defends the futures side, SEC defends the securities side. This question needs a mediator.

My view on one-pot, two-pot is that the discussion is a crock pot.

(Laughter.)

One pot is an expensive proposition for many firms, as they would have to completely overhaul their legacy back office systems in order to make it work. Two-pot can be achieved via software bridges that connect the futures and securities accounts and analyzes the risk of the combined position. You should let the firms decide which way they want to handle it, whether the income from the collateral reinvestment will exceed the cost of overhauling their systems.

Segregation SIPC, that's fixable. The benefits of better capital treatment would probably outweigh the protection of segregation, so let the customer opt out if they want, or ask SPIC to cover futures in the security account.

Market manipulation. Recordkeeping requirements could be more uniform, which will allow for similar high resolution audit trails from both the securities and futures sides. Perhaps a shadow organization equally shared by the SEC and the CFTC could be established to collect and analyze data from all trading and clearing organizations and share the output. Perhaps the exchanges would even allow you to co-locate the service so you will have instantaneous access to the data.

Product and rule certification and CFTC-SEC cooperation. This has to be fixed. There are products that trade on security exchanges that OneChicago should be able to trade futures on. The SEC calls them securities, but the CFTC doesn't always agree. Think of the gold fiasco. More recently OneChicago listed for trading a number of products that met the SEC definition of the term but the CFTC asked us to suspend trading. After six days, we called the CFTC and they finally said okay, you can trade them. We don't know what they did.

In another instance we have a me too filing, a me too filing that should be approved. It's stuck somewhere at the SEC and the CFTC as staff argue. We don't have any control over it. So what I would say very quickly is, memorandums of understanding between the commissioners are great PR, but the staff hammers out the details.

And if you really would like real progress, staff has developed institutional biases over the year that prohibit them from participating in honest, intellectual debates. Accordingly, if you decide to go with joint regulation, you may want to consider a massive overhaul of the two staffs and bring in some fresh thinkers who preferably come from a trading background.

I'll take questions if you ask.

CHAIRMAN SCHAPIRO: Thank you, David. And I would just add to what you said that we're very interested in any conversations with you in the area of securities lending, and we'll be holding two days of roundtables at the end of this month to start to really shine a light on a very opaque market.

Ken?

MR. RAISLER: Thank you. Chairman Schapiro, Chairman Gensler, commissioners and staff, thank you for inviting me to testify on harmonization of market regulation between the CFTC and the SEC. I'm a partner of Sullivan & Cromwell LLP. We represent a number of participants in the markets regulated by the CFTC and SEC. However, the views I am presenting today are my own.

As many of you know, I had the honor to work in the federal government in the 1970s and 1980s. I served as general counsel of the CFTC under Chairman Susan Phillips and alongside now Chairman Schapiro. Before that, I worked for five years in the Department of Justice and would be happy to address Commissioner Chilton's questions regarding the agencies having criminal prosecution authority.

In my many years of working in the industry, I know that successful harmonization depends on personal rapport and commitment. In that regard, I'm pleased to see the two agencies being led by such capable individuals dedicated to effective regulation and market integrity.

I do have a few thoughts on harmonization I would like to share. Chairman Gensler's recent letter to congressional leaders provides a road map for harmonization of the regulatory structure. As Chairman Gensler pointed out, legislation passed by Congress should avoid duplicative regulation and establish a primary regulator that has jurisdiction over specific products, markets and market participants.

Although his statement was in reference to mixed swaps, a particular product area, I believe it can be applied more broadly. As he noted, and I quote, "Dual regulation suggests that both agencies will be regulating the same activities, which may yield duplication and inefficiency. Instead he urged Congress to designate one regulator based on whether the swap is primarily security-based or if it's primarily anything else. I believe this principle of primary regulator should apply more broadly to regulations enforcement and oversight for the security and commodity markets.

And more emphatically, this is true I think if the agencies get the authority that the Treasury is proposing with respect to OTC products. There should be a primary regulator for a given product and market. The other regulators should be consulted where necessary or appropriate, but should generally refer to the primary regulator. This approach should reduce legal uncertainty and effectively speed needed products to market.

I believe that harmonization does not mean identical regulation. Harmonization in my view means that different regulatory regimes reflecting the important differences between the markets and products they regulate are based on consistent principles that are adapted to the needs and circumstances of each market. Harmonization should ensure that regulations are properly developed and implemented to account for the differences between market participants and various markets.

As we discussed yesterday, while the securities markets have many smaller retail customers, commodity markets participants tend to be larger institutional or commercial participants. Therefore, regulation that is designed to protect retail customers, should allow greater flexibility for better capitalized end users.

This is also true for the regulation of exchanges, the new category of alternative swap execution facilities, the ASEFs, and clearinghouses. The precise regulatory requirements that are applicable to each of those categories can differ based on the underlying products and the persons with access to the relevant markets. Although my arguments for regulatory harmonization are generally forward looking, there is significant historical precedent for regulatory harmonization, particularly in the area of insider trading, that recognizes the differences between futures markets and the securities markets. Indeed, I'm happy to continue the dialogue begun yesterday between Commissioner Walter and Mark Young on this topic.

In 1982 as part of the reauthorization of the CFTC at that time, it seems like a long time ago, Congress noting the regulatory disparities between the CFTC and SEC -- we'd been here before -- requested that the CFTC report on insider trading in the markets. In a 1984 report, the CFTC noted that, and I quote, "Certain traditional notions concerning the legal requirements for establishing insider trading under the securities laws are of limited applicability, if any, to the futures markets." Close quote. For example, a security insider is deemed to owe a fiduciary duty to the issuer of the security and its shareholders. While that's so, transactions in the futures markets do not create a similar fiduciary duty.

In addition, the report noted that information that affects futures markets is generally not firm-specific, which is normally the case with regard to securities markets. I commend this 1984 report to you. I believe it remains very relevant even today.

Finally, with respect to harmonization, I think that this is a unique opportunity for both agencies where the opportunity is to look at the differences in regulation and market structure and encourage the best ideas of each agency that can promote competition and innovation. Successful ideas of one regulator in an industry should be carefully examined to determine if they could be beneficial to the other.

One example of this innovation is the promotion of fungibility in the equity options markets, to the extent that the fungibility model has allowed new exchanges to enter the market and promote innovative products and will encourage competition among exchanges and among clearinghouses is worth considering. Other ideas, including the new product approval process on the futures side, are worthy of consideration in the securities environment. The existence of two regulators with comparable but not identical missions should be an opportunity for harmonizing in such a way as to pick the best ideas of each to the benefit of the other and the market as a whole.

I want to thank the CFTC and SEC as well as

Chairmen Gensler and Schapiro for affording me the opportunity to share my thoughts on regulatory harmonization with you this morning, and I look forward to answering your questions.

CHAIRMAN SCHAPIRO: Thank you, Ken. Bill?

MR. McLUCAS: Thank you. My name is Bill McLucas, and a long time ago I used to be at the SEC. I know our topic is enforcement, but if you listen to the list of issues that Chairman Gensler articulated at the outset and then listen to what we heard from Dave Downey, who lives with this in the real world, and the issues that Ken just mentioned, I think the broader issue really is less one of enforcement than whether we can come up with a fundamentally more uniform regulatory framework that reflects a much more common perspective on the markets and on some of the key issues that implicate enforcement: Investor protection, some rationalization of what the rules are in connection with the suitability concept and where it applies and does it apply; insider trading, where does it apply, should it apply in other markets; margin.

All of those issues it seems to me which are fundamentally enforcement related really derive from the far larger question of whether we can develop a uniform regulatory perspective. My personal view is that we had an opportunity that was lost to consolidate the agencies. And it is what it is, and we are where we are, but if I were king, which I am not, and if anyone asked, which they have not, I would pick up, given where we are today, on the development that Rob Khuzami, the director of enforcement, has announced in the past several months, which is this notion of specialization and creating units and groups to focus on particular areas of the market.

And I would think that it's at least worth entertaining the idea of taking six or ten or fifteen SEC staff and the same number of CFTC staff and putting them under the same roof, and saying to them, you all have a mission and that is where there are areas of market abuse, market risk, you ought to conduct investigations under the joint authority of both agencies with both statutory mandates being invoked, and you ought to take a look at whether there are problems in the marketplace, and you ought to come back to us with rational recommendations as to what we do.

Now it may or it may not work. My thinking is that perhaps at the ground level with the staff people who go out and actually work together and take a look at what's going on in the marketplace, we would end up with some recommendations and some approach to enforcement and to practical solutions to problems that would work.

I don't know as I sit here whether there is a sufficient universe of problems that would implicate the mutual jurisdiction of both agencies in the enforcement arena to justify that kind of allocation of resources. It would take some flexibility and some -- and probably you'd get some resistance, as you get in any institution when you propose a change, but it's an idea that I would think at least someone might think about, and we could see whether working from the bottom up rather than the top down, we could come up with some approaches that make some sense.

The biggest concern I would suggest to you is not an enforcement concern in the market we're in right now, given the events of the last two years, and that is we ought to be worried about greater transparency to people who can assess market risk and the broader issue of systemic risk.

And the final thing I'll say is that it was only about two years ago believe where the Treasury Department convened a panel of the most distinguished government and private sector representatives to talk about market competitiveness. And that program was held over a two-day period at Georgetown University. It was really a program designed and a forum in which there was a lot of discussion of the problems with Sarbanes-Oxley and why it was inhibiting our competitiveness, our market competitiveness in the United States.

Now I believe there are problems with Sarbanes-Oxley and there are issues to be addressed, but when you think about the fact that that thinking was prevalent in our capital markets two years ago and where we've been in the last 24 months, the message I would suggest that we all consider today is, and I think we see it from the regulators, is tone is important, perspective is important, and balance and not getting too absorbed with the idea that free markets and innovative ideas really are the answer to everything. And I think we need to be careful.

As I said when I began, I think there are some issues with Sarbanes-Oxley. I think there are some criticisms that many of us in the private sector with the regulatory approach to law enforcement, but those are what they are. The important thing is that we keep our eye on the ball from a grander perspective. I think the regulators today are doing that. If anything, I'm worried about the pendulum swinging too far in the other direction, especially with my clients. But as I said, and I'll conclude here, I think the issue of enforcement is less the issue than whether we can rationalize an approach to regulation that makes more sense.

CHAIRMAN SCHAPIRO: Thank you, Bill. Damon?

MR. SILVERS: Thank you, Chairman Schapiro. I'm Damon Silvers. I'm associate general counsel of the AFL-CIO, responsible to some degree for the labor movement's interest in capital markets and our members' pension investments. I also serve as the deputy chair of the Congressional Oversight Panel for TARP, which submitted a report to Congress on regulatory reform, which I commend to you all. I'm obviously not here on behalf of the panel or its chair or its staff.

I'm going to focus today on, and I think in some ways very much in the vein of Bill McLucas' remarks, on harmonization in the context of derivatives regulation, where I think the issue of regulatory gaps has been, shall we say, most prominent. This is particularly important because derivatives contracts really -- to say something is a derivative tells you nothing about its economic content. As a result, if you have regulatory gaps in the derivatives markets, they can essentially infect the regulation of anything -- securities, futures, commodities, options, indexes -- anything.

That regulatory gap I think was a fundamental contributor to the events of the last two years that Bill was just referring to. We believe that there are three basic principles that two of you -- that the Commission, that the SEC and CFTC should look to in trying to develop a comprehensive harmonized approach to derivatives regulation.

Before I get into this, I also want to say that we've been extremely impressed by the efforts that both commissions have made over the last few months in trying to both work together and restore regulatory comprehensiveness to our markets. I think the public is grateful, and you deserve a lot of credit.

The three principles I want to articulate here are first that collectively, regulators need to have broad flexible jurisdiction over the derivatives markets. We cannot design -- it will be self-defeating to design a re-regulatory process that is effectively rigid enough that it can be outmaneuvered by market practitioners.

Secondly, the basic principle of allocating jurisdiction as long as the SEC and CFTC remain separate agencies -- and here I very much concur with Bill McLucas's comment that the right answer is merging the two. But as long as they remain separate agencies, basically the SEC ought to have jurisdiction over financial products, the CFTC over physical things.

Thirdly, it's just vital, and here we come really to enforcement, that the anti-fraud and market conduct rules for derivatives must be no less robust at a minimum than those rules for the underlying assets the derivatives reference. This is a critical principle. It is necessary but it is not sufficient, meaning that, and I'll get to this in a moment, the next question after you make that principle out there, is are your anti-fraud and market conduct rules for the underlying instruments, are they strong enough? I think that's the key question that you will face in this area. I think a number of the panelists touched on it.

Now we've noted in a number of places that we think that in general, derivatives ought to be traded on fully regulated, transparent exchanges, and that any exceptions to that for truly customized items ought to be narrowly tailored. Let's put it that way.

Now this issue of jurisdiction we feel is the critical point. And again here, we want to commend Chairman Gensler for your efforts in this area, your proposals that in the proposed OTC Act that Congress eliminate the exemption for forex swaps and forwards, we believe is a very important and positive suggestion. We also very much agree with your proposal that mandatory clearing and exchange trading of standardized swaps should be universally applicable, and there should be no exemption for counterparties that are not swap dealers or, quote, "major swap participants." I can get into the reason why we think that's so important in questions.

Finally, though, in relation to jurisdiction, is the boundaries issue. This is really dangerous. To the extent that there is a boundary between two regulatory systems, and it's possible through product design to cross that boundary, move back and forth across it, you have a very dangerous situation where a gap, to quote my fellow panelists, can emerge in the context of an overlap. We think that in looking at this, the two commissions ought to strive essentially to smooth that gap so that that opportunity to cross over by product design doesn't present itself.

And we're particularly concerned here about the possibility that you could design mixed products that were 50-50, and that it would be very difficult in that context absent either a joint regulatory jurisdiction or a kind of task force of the kind Bill talked about, it would be very difficult to deal with that situation.

Now, finally, when I get to the points about the weakness of underlying investor protection approaches, particularly in the commodities area, and obviously this is -- Chairman Gensler, you've inherited this. It's not your doing. But again and again we see in this area the law just inadequate investor protection. Specifically, the absence of insider trading prohibitions, an intentionality standard rather than a recklessness standard for market manipulation, which essentially requires that Chairman Gensler and his staff be mind readers in order to win a case.

And finally, the issue of rules and principles where the structure of oversight that the CFTC has in relation to clearinghouses and exchanges really puts burdens on the CFTC in policing its principles that are very difficult to meet. Here we see the sort of manifestation of the idea that, quote, "principles-based regulation" is really a code word for weak regulation. That's not true. Principles are a key aspect of any strong regulatory framework. But in the context of the political environment that Bill was referring to just prior to the bubble collapsing, we had a circumstance in which, under the banner of principles, regulatory coverage and regulatory substance was weakened unacceptably.

In building a harmonized system, the appropriate thing to do is to build a system that has both rules and principles, but most importantly is strong, comprehensive and flexible. We have a great deal of confidence that under your leadership, both bodies will come together and do that.

It's incredibly important in terms of ensuring that we don't revisit the events of the last 24 months, that the process you undertake results in truly comprehensive, inescapable regulatory coverage in the area of derivatives, and that the basic investor protections I discussed earlier are strengthened now that we're going to have -- Congress is going to take a comprehensive look at these things. And hopefully, part of your recommendations will be recommendations so that that boundary is less and less meaningful.

And like I said, if we can be of any help to you, don't hesitate to call. Thank you.

CHAIRMAN SCHAPIRO: Thank you. Richard?

MR. OWENS: Thank you, Chairman Schapiro, Chairman Gensler, ladies and gentlemen, members of the Commission. I very much appreciate this opportunity to speak with you today. My name again is Richard Owens. I'm a partner at the law firm of Latham & Watkins, and like other panelists, I spent much of my professional career in public service, nearly a decade in the Securities and Commodities Fraud Unit in the U.S. Attorney's Office in the Southern District of New York, and the last four years as the chief of that unit, as so have, while I've never been a member of the staff of the SEC or the CFTC, I hope that there was at least a period of time when I was considered a stepchild.

I certainly had the opportunity to work on a number of very significant cases that involved investigations jointly with the SEC and the CFTC, where both agencies had jurisdiction and where the events that were under investigation had significant impacts on both the securities and the futures or commodities markets.

I'll name a few examples just to give you some context, because I think it may help with respect to my following remarks. The Refco collapse, the prosecution of Martin Armstrong for what was then the largest Ponzi scheme, involving both securities and futures, and a long-term undercover operation, which was termed by the FBI Wooden Nickel, into abuses in the forex market which took the form of both futures, spot trades and private placements of securities to fund forex trading.

And from the experiences that I gained in those cases, I was thinking in preparing for today what lessons could I distill and advice could I offer. I certainly can't speak as globally or eloquently about regulatory harmonization as the prior speakers on the panel, so what I'll try to do is focus on some very particular nuts and bolts recommendations that I think could help the agencies harmonize their enforcement efforts.

And first let me begin by commending what is underway in the Division of Enforcement at the SEC, led by my old friend, Rob Khuzami, in streamlining the SEC's processes for initiating investigations and issuing subpoenas. Over the years, that was a particular source of concern and friction in joint investigations between DOJ and the SEC. The lead time it took the SEC in the midst of a breaking investigation to get subpoena power could sometimes hamper the investigation or curtail the SEC's participation in it. The CFTC, by contrast, always seemed to be much more nimble in that regard and was able to get subpoenas out much more quickly and to get formal orders much more quickly and to move their processes along.

But another aspect of the reforms that are being considered at the SEC now, I do believe that the CFTC should think very hard about. And those are the recommendations to consider adopting at the agencies the use of tools that have been a mainstay of the Department of Justice's armory for many years -- cooperation agreements, deferred prosecution agreements, and frank conversations, candid conversations from line attorneys with defense lawyers early on in the process, letting the defense lawyers know where their client, who may in fact be a very helpful potential witness, was likely to shake out, at least in terms of what evidence was then known to the government.

I think those are very important tools for a number of reasons, and that both agencies should have them. Both because they help to push investigations more quickly when you can offer a target of your investigation or a subject some protection or benefit, you can get information out of them much more quickly, and that redounds to the benefit of the agencies, the efficiency of their investigations, the recovery of assets quickly for the protection of investors, and works to everyone's benefit.

There are also many instances when the use of the tools can help to ameliorate or provide some degree of leniency in situations where otherwise the full weight of the law would not necessarily be appropriate to bear on an individual or an institution.

Along those lines, I'd also urge the commissions to consider the following. For a number of years the CFTC has had -- I believe they were promulgated in '94 -- guidelines relating to the imposition of civil monetary penalties. And the SEC, I'm not sure that those guidelines have been updated by the CFTC in a significant way since '94.

In contrast, the SEC came to the civil monetary penalty game much later. They got their congressional authority much later than the CFTC, and the SEC has issued statements like the Seaboard report. There have been statements by commissioners and by Division of Enforcement chairmen about the imposition of sanctions.

What I would urge the commissions to consider as the first step in harmonizing enforcement is to draft a joint set of principles for the imposition of sanctions, whether they be civil monetary penalties, industry bars or other remedial measures, a joint set of principles for how the commissions will exercise their discretion in deciding what cases to bring and what charges to bring in particular cases, and when to seek sanctions against institutions as well as individuals, not unlike the various memos that have come out of the DOJ over the years, the Holder memo, the McNulty memo, et cetera, which are controversial for their privilege waiver issues but have never been particularly controversial with respect to the fact that they articulate guidelines which guide federal prosecutors around the country in making charging decisions.

If you issue such guidance, I think you will find it a worthwhile exercise amongst yourselves to have that conversation, to think long and hard and talk to each other about how you make the decisions about the cases to bring. It will allow you to communicate a joint vision to your staff for them to follow, and it will certainly give those of us in the defense bar and those in the industry a very good recipe that we must follow to stay on the commissions' good side.

Thank you very much.

CHAIRMAN SCHAPIRO: Thank you. Jack?

MR. COFFEE: I'm Jack Coffee. I represent no one. I speak for no one. I'm just a humble law professor and basically no one listens to me either. I have prepared a memorandum that discusses twelve different areas of significant disparities between the SEC's approach and the CFTC's approach, and I do not assume the disparities are inherently bad. But these are twelve areas that require further study. I devote on average a half page to each, which is cursory, shallow and superficial. It's what we law professors call the bikini approach to law teaching. You cover the critical points but only just barely, and that's all that I've done.

This morning if we have time, I want to cover just the first three: Insider trading, what I'll call market power manipulation, and the issue of the suitability rule, particularly in light of the Administration's view that brokers should actually be given a statutory fiduciary duty, which specifically increases the disparity between the two agencies.

Before I go there, I think we are all ignoring the 600 pound gorilla in the room this morning, which is that the Inspector General's report came out last night and it's all over the headlines. There are some messages here for financial fraud enforcement across all agencies. And I happen to believe -- this is said as a premise -- that the SEC is the best of the federal agencies charged with the responsibility for protecting the financial markets from fraud. I continue to believe that. But there are challenges here, and things have to be done to restore investor confidence.

I'm not going to go through the tabloid-level details of the Inspector General's report, but when he offers the view that the Enforcement Division by making just one more phone call could have detected this fraud at a variety of junctures, I suggest that it shows a deeper organizational problem.

Within large bureaucracies, and the SEC is a large bureaucracy, there is often a tendency for individual offices and individual units to pursue a sub-goal, a sub-goal which is their mission, but it is not really reflecting the broader purposes of the overall agency. Thus, you may be concerned about protecting the markets from a violation of Rule 17A(f)(c)(2)(4), but therefore you may not focus on what we're looking at is the largest financial fraud in history. And you may be willing to settle for a settlement that says the defendant will now enter into some kind of settlement and register as an investment advisor. That doesn't really meet the broader problem of whether you have discovered facts pursued two steps farther will suggest the largest fraud in history.

Thus, what I would suggest is that in light of this particular episode, which is frankly the worst embarrassment in the SEC's long history, for which no one on this panel bears any responsibility. This occurred on a prior watch. But it occurred over 20 years, so it can't be blamed on just one administration or one particular SEC chairman or staff member.

I think that because of this danger of pursuing the narrow sub-goal, among the things that should be considered is broader fraud training. In fact, you might consider a sort of fraud college program under which new staffers at both the CFTC and the SEC go, because fraud is fraud, and it has the same warning signals, and you might look at what we should be looking for, not distinguishing CFTC staffers from

SEC staffers or Federal Energy Regulatory Commission staffers, who also investigate financial fraud manipulation. That kind of practice, what I see in this report, is the danger that well meaning people who are in no case corrupted, there's no evidence of corruption in all these reports, are behaving a lot like the seven blind men investigating the elephant. They all come back and report on the tail and the trunk, but no one notices, we've got one huge elephant here that is a huge fraud. That's what is missed by not -- and this is where specialization can be a danger as well as an asset. If you're overly specialized, you don't put together the broader picture.

I'll conclude on this point by saying a former SEC chairman suggested to me within the last six months that the real danger that he saw from the Madoff affair was that internally, the SEC may have something -- he termed it a silo culture, under which there are different silos within the agency, vertically structured, and they do not share information well, they do not integrate all the information they have, and they do not get the larger picture. And between compliance, enforcement or broker-dealer regulation, something here was in each of those agencies that was never adequately integrated. It's breaking down that silo culture. Sometimes specialization may do this with the enforcement division, but the greater danger is, its specialized units do not share the information well. And I think that on the organizational level is the message that should be drawn from what is the current developing scandal.

Okay. Now let me go back to my memo and just go briefly through these three topics. Insider trading. This is the huge disparity because basically the CFTC has no jurisdiction over insider trading in any way, unless a commissioner or a Board of Trade member engages in it, and shame on you if you do, but that's not what the country is worried about right now.

Now, I agree that Dirks'-based classical insider trading doesn't have that much relevance to the world of futures or derivative trading. But Dirks'-based classical insider trading is only one of what I'll call three basic SEC theories of insider trading.

The next, well known, is O'Hagan-based misappropriation of information from the source. That can be occurring every day while the CFTC is powerless, sitting on the sidelines. How could misappropriation occur? I could imagine a trader in the futures markets or in the swaps market bribing a low-level employee in the Federal Reserve to get information about what interest rates will we move to in one week, or what the money supply will look like next week when the Treasury does something, or what the level of commodities are in a particular commodity from the Department of Agriculture. That information is being embezzled from the source that's classic misappropriation under O'Hagan, but there is no authority to deal with it in the CFTC.

Next case. I fully agree that Exxon or someone else or American Airlines should be able to investigate, do research on the future oil market, decide there's a price spike coming, and hedge because they have great needs. Anyone can do elaborate investigation and has no obligation to share that research with others.

But what happens if an employee at Exxon learning of this information misappropriates it and trades in the oil market for his own account, making a huge profit based on information that Exxon has elaborately developed? He is misappropriating or embezzling information from Exxon, and I think that is -- should be a criminal and civilly enforceable misappropriation. There is no social interest in protecting the misappropriation of information from its source.

Third category of insider trading. The SEC won a significant victory in July in a case called SEC v. Dorozhko -- I'm mispronouncing it probably -- in which the Second Circuit ruled that even when there is no fiduciary breach, if you acquire information by deceit -- and this involved a case of pure computer hacking -- if you break into the computers at Morgan Stanley or the Federal Reserve and get confidential nonpublic information, it should be criminal to use that even though there's no fiduciary breach, and I think we should not have the significant enforcement staff of the CFTC sitting on the sidelines unable to deal with that. Yes, I know some of these cases can be criminally prosecuted, but that's the line of last resort. The first resort should be the civil agency charged with the responsibility having authority to deal with those kinds of insider trading.

We move on next to market manipulation. Here the world is very different between the SEC and the CFTC. The typical SEC case is the pump and dump case, and that's not hard to prosecute because there are false statements being made. The typical CFTC case is the market power manipulation. No one is saying anything. It's totally silent. That is close to being unprosecutable.

Professor Markham 20 years ago, 18 years ago, went through all of the cases and found that it was essentially unprosecutable. The world has not changed that much since he wrote that article. Yes, there have been some major successes like the Sumitomo prosecution where there was a huge private class action and CFTC settlement. But it remains very hard to prosecute.

The problem is this concept of artificial price is always going to be difficult to establish in court. My suggestion would be not that a new definition of market manipulation will solve this problem, because I read over this last weekend a half a dozen Law Review articles dealing with this for ten years, and they all have very intricate standards which I don't think ever could be explained to a jury successfully.

I think you should look at other weapons, including the use of position limits. You have the ability -- this was Professor Markham's suggestion -- to put out a warning that this is now a congested market. This is a market that's in some danger of manipulation, which is not a finding that requires any special determination, and based on that, you could either put position limits on traders or ask traders to liquidate large positions that could not be shown to be purely hedging positions. I would certainly give an exception for the hedging position. But I think those alternatives as to strive to continue to always prove manipulation with relatively little success. Again, this is where the worlds of the CFTC and the SEC are very different, because the SEC is rarely confronting a pure corner. It's usually confronting the pump and dump where there are false statements.

Last topic and then I'll stop. The world of suitability. Again it's a day-and-night difference. The suitability rules of the SROs, which was the NASD and now FINRA, and I must say that if there is a success story in terms of the world of regulation, it has been the evolution of FINRA over the last ten years. The people responsible for that are up here, but I won't point fingers at them to give them credit or blame today.

But I think that arming FINRA with a strong suitability rule has done some good. There is no similar suitability rule with regard to the CFTC. I understand the relationship between the FCM and the client is significantly different, but there are -- the world is full of small pension funds that lost their shirt buying CDOs that they did not understand because they had no in-house capacity to evaluate these, and they didn't do -- could not do their own research. Brokers should not have been selling those CDOs to those school boards in Florida, to those little colleges, and to those pension funds, some of them being union pension funds, who did not have that capacity.

Now CDOs may be securities, but you can design these products so that they fall on either side of the line, whether it's credit default swaps or it's CDOs, they can be designed either way. I think there should be at least a minimal obligation that you should not be selling some products without first making an evaluation that this client has the ability to understand what it is that it's buying and to bear that level risk.

Again, that's not saying it should be the equivalent rule, but the point of a suitability rule, which is more than a know-your-customer rule, is that it could be enforced in private arbitration. Private arbitration does not involve securities class actions, it does not involve the allegedly bounty hunting plaintiff bar, it is a world that can deal quite fairly and quite responsibly with claims that this particular investment was not explained to me properly. I think that that is sort of the minimal answer.

Given that we may soon have a world in which the broker-dealer actually has a fiduciary duty to the client and the FCM -- the equivalent -- and in most cases it's the same integrated financial firm, whether it's Goldman, Morgan, Merrill, whoever else -- they shouldn't be on one side having no duty, not even a suitability duty, on the other side having a fiduciary duty to the client. At least an intermediate position is a suitability rule that would be enforceable in private arbitration or enforceable through actions brought by the CFTC. None of that involves all of the dangers of unleashing class action litigation.

I've covered three of at least ten topics, all superficially, and I'll stop at that point.

CHAIRMAN SCHAPIRO: Thank you very much, Jack. I have a couple of questions for the panel. Let me start though with a brief comment in response to your points about the Inspector General's report on Madoff, and I would love to walk through all the changes that we've been trying to make and have made at the SEC over the last six months that are very much in response to the agency's failure to early on detect the Madoff scandal.

But the one I want to comment on actually is the fraud college idea, because I think it's a very interesting idea, and we have significantly stepped up our fraud training in conjunction with the SROs in particular, but we also have over 300 examiners right now going through the Association of Certified Fraud Examiners training program to get that certification, which I think will be important in our ability to look at the bigger picture, to spot the red flags, perhaps outside of the narrow scope of what the examiner is actually in there to look for. So I think the fraud college concept is a great one, and I think the idea that maybe the SEC and the CFTC could embark on some of this together would be particularly valuable.

The two questions I have before I turn to each of my colleagues, the idea that Bill McLucas raised, which I'm fascinated by, that we take some people and put them under the same roof and have them make an investigation of market abuse that invokes the authority potentially of both agencies. I'd love to know what other panelists think about whether there are areas -- and we obviously know there's plenty of securities fraud, there's plenty of commodities fraud, there's plenty of forex and other kinds of fraud --

what your thoughts are about whether there are areas that do in fact clearly cross the line that we ought to be thinking about.

MR. SILVERS: Mary, in my written testimony I address this type of idea as a possible way of dealing with the boundary problem in derivatives where you have a mixed -- where the underlying assets are a mixture of commodities or items under the CFTC's jurisdiction and items under the Commission's jurisdiction.

I didn't flesh it out, but I think that is one approach to that type of mixture that avoids the boundary problem. I think if you did it -- if you had that approach, you would have -- you'd have to resolve the question of what happens if the two staffs disagree, and what's the governance, who's the tie-breaker, that sort of thing.

It's appealing to me as a way, again, of getting away from a cliff of some kind in the regulatory system which then becomes an incentive, you know, essentially for regulatory arbitrage.

MR. ROTH: Most of the cases that we have brought where we had to reach out to both the CFTC and the SEC to try to get some help have involved collective investment vehicles. And I think that's certainly an area. The overlap there is going to grow as hedge fund registration moves forward, and we're going to be dealing with that on a more frequent basis. So I would certainly identify that as one area where I think the idea of personnel from both agencies sort of working together to focus on a particular area might bear fruit, because that's the area that we've seen at NFA where it comes up most often.

CHAIRMAN SCHAPIRO: Anybody else on that?

(No response.)

CHAIRMAN SCHAPIRO: Professor Coffee, in your -- you mentioned this obviously because you covered market manipulation, and I'd be interested to know, and it's raised in your written testimony as well, what do you think we in the CFTC should ask of Congress in this area? You talked about position limits on the CFTC side. I know there's huge frustration at both agencies, the difficulty of prosecuting market manipulation cases. Is there something we should be seeking from Congress that would make it easier for both agencies to prosecute those cases?

PROFESSOR COFFEE: I think we should distinguish between criminal and civil investigations. I think that the criminal charge of market manipulation probably is going to have to be a high scienter statute. I don't think that could be simplified in fairness to the defendant. But I think that there could be ways that you could grant on the civil side, cease and desist orders, which wouldn't require you find making this stigmatizing finding that you have engaged in a manipulation, because that will trigger all of the class actions whether they're securities or commodities class actions. Rather, if you could give a cease and desist order saying this market has become congested, and as a result, unless you can demonstrate that this is a purely hedging order, a large trade could not make trades, because it only would apply to the large trader. We could define what a larger trade is. But the cease and desist order would say during this period of congestion, until we release this congestion finding, the large trader could not make non-hedging trades. You could be -- there could be safe harbors, there could be exemptions. That doesn't require making the finding that there's been a manipulation, which I think inherently is going to take months and months and millions of dollars because it will carry a huge price tag for the defendant in terms of the class actions that will follow. I'm trying to suggest a lesser alternative that will decongest the market prospectively without having to trigger all of the conclusions that follow from a finding of manipulation.

CHAIRMAN SCHAPIRO: Kenneth?

MR. RAISLER: I mean, I would submit that that authority already does exist and is utilized on a relatively regular basis, both at the CFTC and more particularly at the exchange level as they monitor the markets actively. So if the exchange or the CFTC from its surveillance program believes that somebody is engaging in congested -- the market is congested and their behavior has the potential to exacerbate that -- there is clearly contact made. Now that could be done more actively and more progressively, but I believe that that doesn't require an act of Congress. I think that's already embedded in the CFTC's oversight authority. And so -- and I think there have been many occasions where people have had to reduce their positions in the market even though they haven't really felt that they've done anything wrong, and that's certainly implicit in the oversight process. So I'm not sure legislation is necessary to accomplish Professor Coffee's --

MR. COFFEE: Just -- and I'm not disagreeing that authority exists. As opposed to making an individual specific finding that you have done something, the cease and desist order would say in this congested market, no one, without making any finding about them, may make further non-hedging trades until we release the congestion finding. That's somewhat different.

MR. SILVERS: I don't have the expertise to resolve whether there's an act of Congress needed to address this, but I do want to call to the two commissions' attention to how important this issue is potentially for our economy.

Bill referenced how much things have changed over the last 24 months. So much has happened in the last 12 months that memories of the situation with energy prices a year ago may have faded. They have certainly not faded in the minds of people who run the operating companies of our country. And the types of enhanced mechanisms that Professor Coffee is talking about would seem to speak directly to circumstances that the commissions need to have strong tools to deal with, because, you know, effectively, I think it's unclear what exactly led to the oil price spike last summer, but there is I think is continuing concern among end users that markets were manipulated. And it's unclear -- there's an issue of will, whether anyone had the will to act at that time, but I think there's also an issue as to whether or not the CFTC has the proper tools to deal with the recurrence of that sort of situation. The consequences for our country, for jobs, for incomes, for people to afford to do what they need to do in life, can be quite severe.

CHAIRMAN SCHAPIRO: Okay. Thank you. Commissioner Casey.

COMMISSIONER CASEY: Thank you, Madam Chairman. I'd actually just like to follow up on this discussion. I think it was actually raised yesterday, maybe by Commissioner Walter, with respect to -- and maybe Commission Aguilar as well, with respect to surveillance capability, audit trail challenges. And so what I'd like to do is hear from Mr.

Raisler, because I think this is an important point with respect to existing authority whether or not additional legal requirements would be necessary to get to concerns about the adequacy of enforcement efforts in addressing market manipulation concerns, is how much of it is an issue about our capabilities in the surveillance area as well as greater cooperation, coordination and information sharing among the agencies, but how much of it is our tool set areas, as our capability on surveillance?

MR. RAISLER: Yeah. I mean, it's my own belief that the statutory authority of both agencies is adequate, and that improvements can be made along the lines that Chairman Schapiro is suggesting here at the SEC but also at the CFTC and cooperatively. I think there were suggestions yesterday made about sharing of surveillance data between the two agencies on a more active basis that really has not historically been the case.

And as markets move, I think the CFTC's surveillance department has done a good job, but they could certainly do better. I think the CFTC has been dramatically under-resourced for decades, and that the need for resources in the enforcement area and in the surveillance area, and, you know, literally I'm talking, you know, bodies and computer servers, I think we're talking basics here. I think that they would be much better off being able to pursue the leads that are out there if the resources were there.

I don't -- I mean, I appreciate and actually I could respond to Professor Coffee's arguments in the insider trading and manipulation area one by one, but I don't think it's really an inadequate statute that really hinders the agencies' ability to do their work. Actually the reality is I think the agencies have really been quite effective for the most part. There obviously have been some problems that have been documented. But I do think that with more resources and more skills and more training, we could see huge improvements here.

And, I mean, I think that's underway. I mean, I think that the direction there is a positive one. And, you know, it's amazing when you think about it to realize that the CFTC has operated, you know, with effectively the same staffing since it was created in 1975, given the growth of the markets, the OTC markets, the energy markets, and on and on, so.

The only other comment I would make is that, although not directly related to this harmonization discussion, Congress has seen fit to give the Federal Trade Commission and FERC jurisdiction in areas that overlap to some extent with the CFTC as well. And so when we're sending our people to fraud college, I would hope that the admission standards would allow those agencies to be included in the entering class.

COMMISSIONER CASEY: Thank you. Are there any others who have comments on that?

(No response.)

COMMISSIONER CASEY: I have one additional question then, which is to follow up, Mr. Owens, on your recommendation with respect to establishing sort of a joint set of principles or a statement by both agencies with respect to sanctions.

You mentioned obviously the statements and guidelines that have already been issued over the years by the CFTC and SEC. Could you point to any particular differences or issues that would need to be reconciled in crafting or harmonizing those principles?

MR. OWENS: I don't have off the top of my head particular examples of what are glaring differences. There are differences in language between the documents. But what I think is really missing, and I think it would be a fairly easy exercise, because I don't think there are real significant, substantial discrepancies between the two agencies' approach, but I think what it really needs is a joint expression of that, so that when people sit down and look at it, you don't end up with a set of enforcement lawyers from one agency and a set of enforcement lawyers from another agency engaging in some Talmudic interpretation of the different language used by their respective commissions. If it's the same wording and the same document and the same sort of exhortation to the troops, then you'll get the harmony from your troops that you're looking for I think.

CHAIRMAN SCHAPIRO: Thank you. Commissioner Dunn?

COMMISSIONER DUNN: Thank you very much. Let me thank this panel, because this has been very frank. Your recommendations have been great. It's something I've been looking forward to looking at the gaps that we have and how we might address those.

A lot of this -- Dr. Coffee, you in your points that you make, you delineate at the end that some of these have to be statutorily mandated and some of them we can do ourselves. I'm in the school of thought that there is a lot more that we can do on our own, that we are independent regulatory agencies. We don't need Congress or we don't need the Administration to say one, two, three go. We can sit down in meetings like this and begin to hammer out some solutions to some of these problems that you have raised.

Communication seems to be the wherewithal, and, Mr. Roth, you talk about connecting the dots, and Dr. Coffee, you talk about the silos. Well, there's not only silos within agencies, there's silos intra-agencies as well where we're not talking to ourselves. And to that extent, we have put together a memorandum of understanding to explore communications. And, Mr. McLucas, I think you are very clear about how -- what you think about those MOUs and how well they're working. But it's meetings like this that hold us accountable as policymakers to make sure they meet. To blame that the staff is so entrenched that they're not doing anything begs the question, who's in charge of the staff? We are. And who is in charge of us? The public. So there are things that we ought to be doing and should be doing, and I wouldn't throw the baby out with the bath water.

To that end, thinking out loud here, I'd like to get the reaction of the panel on what if we amended that MOU and address some of the problems we've heard here. Product risk, product placement, whether there needs to be -- whether it's a derivative or a security, to have that group take a look at it, but to ensure that they're following up with the wants of the commissions, maybe having one or two of the commissioners sit in on those quarterly meetings to hold us accountable, or to hold the staff accountable for what we're seeing here. And finally, to ensure that we have outside input and we're getting it right. Both commissions use advisory committees, I've advocated for a risk advisory committee to advise us, but an advisory committee on where that product ought to go, where the risks are, and how to address these concerns of customer protection. And I'd just like to get your thoughts on those -- on that type of a train of thought.

MR. McLUCAS: Well, I -- look, the idea -- I used to go to some of the working group meetings at the Treasury Department when someone more important was unavailable to go and my impression, coming out of that over time, was they were polite gatherings of an hour that were just that. And over time, look, all institutions fall into that.

The idea that you would push the staff people to sit in a room and work on something concrete, my perspective is, since we haven't hit the ball out of the park operating up here, let's do it at the ground level. The idea of integrating someone at the Commission level and then pushing for results, or at least an understanding of where are our differences -- what can we do, what can we not do. Do those differences implicate fundamental philosophical perspectives of the two agencies that can't be reconciled -- then we ought to face up to that.

If they don't, though, and you can make progress on an enforcement approach and a policy approach that makes sense, I think that's a good idea. My view of this is that over time, all of these things will get stale unless somebody comes along and jolts the institution into a new way of thinking. And that happens to all of us whether we're in the government, whether we're in law firms, whether we're in investment banks. And my view of this is that, that, you know, the idea of doing something radical, something slightly different and saying to somebody, "Look, I know it sounds like riding the bicycle backwards. Try it. If it doesn't work, it doesn't work. You can't do worse."

And I think that the idea that you have these two Commissions sitting in a room together in a public forum basically holding themselves out to the notion that we can do better is a great indication, in terms of the tone or the leadership of the agencies and a response to what has transpired in the financial markets in the last 24 months, that we're going to do a little better. Whether we merge the agencies or not, we're going to find some solutions to some of the fundamental problems and we're going to identify them and figure out what the right approach ought to be.

MR. ROTH: The only point I would make would be that when we're talking about this Commodities Fraud or whether the joint investigations between the CFTC and the SEC, what we've found in our experience is that it might be hugely helpful to, as we -- as I said in my written testimony, get all the dots on the same screen, get all the information that we have together between us, together in the same place, so that we can all see it. But that's nowhere near enough because the problem isn't sometimes just getting the dots on the screen, it's connecting the dots. And the problem -- by connecting the dots, I mean spotting patterns of suspicious activity.

And the reason that's hard for us is that most people -- and that's something we battle all the time -- is that you're looking for indicators of the last scam that -- of the previous scams. You know, you're looking for patterns of behavior that arise -- aroused questions in you because of things that you've seen before and you can't be limited to that. The hardest part is identifying suspicious activity that doesn't fit a pattern that you've seen before.

So my only point is, by all means, I think the people working together might be very helpful in getting more information together in front of the investigator body, but you've got to be much more inquisitive and not just look for past patterns of conduct, but look for any activity that arouses suspicion. And it's hard to do; it's a culture change. It's hard.

MR. SILVERS: As I think my prior remarks suggest, I strongly agree with, I think, the proposition that the two agencies ought to look for hands-on operational opportunities to work together and to solve some of the boundaries problems that way. I wouldn't, though, want to leave with you, you with the impression that everything that can be solved here by your two commissions working it out.

There are some fundamental issues of jurisdiction, authority, enforcement standards that Congress is going to be looking to you collectively for guidance. You could do enormous service to the country by speaking in a unified fashion, the two agencies together, seeking that comprehensive change in statute.

I think, you know, this discussion, in a certain way, takes for granted some enormous achievements you've made already in this direction. I think that the basic proposition that is in, I think, both Chairs' testimony before Congress, that jurisdiction and substantive investor protection and market regulation standards in derivatives ought to follow the underlying assets. That principal, which you both embraced and urged on Congress, it is just of foremost importance in dealing with addressing the problems of our financial crisis.

Only Congress, though, can fix it. That's something that's not within your power. And but Congress, I don't think, will fix it properly unless there is a clear message coming from both agencies' real leadership. I think you've laid the groundwork for that in an exemplary way, but you've got to keep going, you've got to keep doing it, because at the end of the day, you simply don't -- these issues can't be properly resolved in this room.

PROFESSOR COFFEE: Very briefly. I just want to commend Commissioner Dunn and give you one area where you could pursue your approach. You are, both agencies, going to get new jurisdiction over over-the-counter derivatives, especially swaps. Neither of you have much experience in dealing with swaps, other than the SEC's insider trading jurisdiction.

If you had a joint task force looking at swaps, because there is only a limited number of large banks trading swaps, and if one agency finds something about a particular bank in trading security-based swaps, maybe they're also trading non-security-based swaps, it's the other agency's problem, and you will find out that it is the same modus operandi in both of those contexts.

So for this new world that we're about to enter where you're going to get jurisdiction over swaps, I think you should form a joint agency task force looking at what you're learning and how to pull the information because it's a brave new world for both agencies.

CHAIRMAN SCHAPIRO: Thank you.

Commissioner Walter.

COMMISSIONER WALTER: Not to beat this idea to death, but I think it's a valuable one. I would like to follow-up on it just for a second and particularly, to follow-up on Commissioner Dunn's remarks. And at the danger of sounding a little preachy, a lot of these issues really have to do with people and leadership and culture. And it's trite to say you are what you measure, but I think you are, and you are what you reward.

So I think it's incumbent on all of the regulatory people up here on the dais and all of the leadership on our staffs to really implement that because if the most fabulous thing that you could do would be to refer a good case to the CFTC, if that were the way to excel at the SEC, people would do it more.

And so I think we really do have to, on a very daily and step-by-step basis, really work on changing cultures and having silo be the dirtiest word that there is. I'm beginning to hate hearing it in any way, shape or form. And without any slight to farmers. But I don't know that it's worth spending anymore time really focusing on this, but I do think it is very much a people issue and a culture issue and it's something that deserves an awful lot of attention.

I would like to slide to the other end of the scale and ask about a more micro issue, particularly in the context of the prospect that we are maybe headed, and I hope we are headed, towards a frame where broker-dealers are going to be subject to a fiduciary duty, at least where they get personalized advice. And I'm a little bit out there on this in terms of advocating an across the board fiduciary duty.

Does it make sense -- I guess I've got two questions. Does it make sense to follow the same line with respect to the duties to which FCMs are subject. And in terms of moving away from line drawing to substance, does it make sense to think about or is it even viable to even raise the issue, of thinking about some sort of a unitary registration regime where really what you basically do is sign up for functions. And your functions, in the absence of merger of these agencies -- perhaps other functions -- would be regulated by a primary regulator, but we would be less worried about what labels were applied to people.

MR. McLUCAS: Yes and yes.

PROFESSOR COFFEE: Yes, but the devil is in the details.

MR. ROTH: Can I -- in an SRO level, the fiduciary duty question is a little bit easier for us to deal with because as an SRO, you always have the standard that members have to observe high standards commercial honor. It's a vague standard, but it's designed for precisely those types of circumstances. If we ever had a situation where a member, regardless of its membership category, was making recommendations to a customer that were in the member's interest and contrary to the customer's interest, we would charge it and charge it in a heartbeat even if we had to use our high standards of commercial honor rule. So at an SRO level, it's a little bit easier to deal with that.

On the questions of registration standards, I mean, the two -- you know, the fitness standards for registration under both acts are awfully close. You wouldn't want to live on the difference. So I certainly think the registration standards aren't different. Obviously there are different proficiency requirements and testing requirements and things like that, but for us, those labels are important because it identifies what that member is entitled to do whether holding customer funds or not holding customer funds. But certainly the processing -- I wouldn't suggest that the fitness standards are in any way different under the two registration regimes.

MR. SILVERS: I think you want to think about this question from the customer's perspective and I think the key thing is something that Jack observed in his opening remarks, which is that these -- the distinction between CFTC regulated and SEC regulated products is not really observed in the business model.

And so I think it's not proper -- it's not appropriate that an investor contacts their brokerage organization and at some point they switch from being under a fiduciary umbrella and not being under a fiduciary umbrella. That switch could occur without -- while talking to a single person or it could occur when the call gets transferred. And that just strikes me as the kind of thing that is the hallmark of an unfair market.

MR. DOWNEY: Everybody, you have to recognize one thing. The way the business is set up for the last hundred and fifty years where people would call brokers and they talked and they would get their advice from over a phone -- you have to tape that phone call -- then they accept an order and they get delivered to an exchange rate. Those days are going to go away at some point. They might even be gone.

So this whole idea about, you know, whether we have the customer calling to trade stock on the New York Stock Exchange or an option on a futures contract, it's going through the same Telco line over the same computer that he has at his home that's delivered to the same organization that that's it for financial capabilities and then passes it along to the exchange for execution and the reverse electronic message comes back.

It seems that you guys are discussing whether we should hold the feet of these brokers to the fire. You should really hold the feet of the software programmer to the fire because they are the ones that -- your problem today I understand, but 10 years from now, this is going to be do you understand algorithms and do you understand how software is written because that's the efficient model.

And all of those brokers who have put their money into those types of systems will eventually compete. They will eventually crowd out the non-efficient broker-dealers and those broker-dealers will eventually just go away because there's just no doubt about it. The efficient transfer of information from customer to exchange back to customer is done by a computer.

COMMISSIONER WALTER: One other brief question that it would be nice to have all of you react to, as I listened to all of your valuable input, I heard some mentions of private remedies. Not that much. And I don't disagree in terms of that not being the priority here, but that's what I would like to confirm. I think it's a very important issue. But I think in the context of this discussion, what I sense coming from you is that private remedies are really something we should turn to after we get the basic picture fixed. And I would like to hear your views on that.

PROFESSOR COFFEE: You're looking at me and I really wasn't volunteering. The class action is not really very effective when we're dealing with debt securities, which is the current crisis, because we're not in an efficient market when we deal with debt securities, and class actions are not maintainable. I think the investor either has to sue alone or in a very small group there or he has to depend upon arbitration and thus, I do think things like a suitability rule would give investors some ability to have relatively low cost arbitrations with brokers about some issues.

But the real world is that the standards for class certification have become so much more difficult and are so unavailable in the world of debt securities that much of the litigation that's playing out in the current crisis is not being brought as class actions.

MR. OWENS: And if I could weigh in here and take this as an opportunity to talk not about private remedies, but about public remedies, I would urge the commissioners that in the process of thinking, as I know you are, about what, if any, recommendations you want to make to Congress, that in your consideration of new legislation, you will look hard at the issue of harmonizing your respective sanctions and remedy provisions.

And in particular, what -- the real thing that has always struck me as so odd is that the SEC doesn't have the power to seek restitution on behalf of investors. It has the power to make restitution because it can take fines and it can take disgorgement and it can use those funds to pay restitution, but the SEC doesn't have direct authority to seek restitution as restitution for a victim.

And it's an important point because restitution and disgorgement are not the same legal concept. Restitution is the amount that the victim lost; disgorgement is the amount that the perpetrator, or the alleged violator, gained; what their profits are. And those two are not just the same sides or different sides of the same coin. They can often be very different amounts.

The CFTC has long had, as I understand it, power to go after restitution as restitution; the SEC doesn't. There is a terrific statute on the books now available to the criminal authorities -- 18 U.S.C. Sections 3663 and 4 -- which would be the ideal model for both agencies to use and would also harmonize the developing case law that exists in the criminal law context about how you measure restitution, what it is and who you have to pay it to, all of which are very important to the issue of remedies to the victims of violations.

CHAIRMAN SCHAPIRO: Very briefly, Damon.

MR. SILVERS: Very. I'm troubled by two things in relation to the private right of action. One is I think the suitability issue would appear to be how you get at the individual customer who has been wronged, misled and so forth.

The thing that troubles me is the problem of agency inaction when a broad market manipulation is occurring. Private rights of action have been, I think, historically a way of dealing with of a sort of fail safe against that problem. The damage that's done in that -- in those circumstances are very large. It can be economy-wide. It's a little hard to think about what the private right of action would -- should look like in such a context. On the other hand, we need to recognize it's very dangerous not to have a fail safe mechanism.

CHAIRMAN SCHAPIRO: Thank you.

Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Madam Chairman. I want to follow-up on some of Mr. Silvers' comments to Commissioner Dunn's question and really appreciated your comments earlier on the harmonization with regard to derivatives and your comments about making sure that there is inescapable coverage for OTC derivatives and wanted to know as we look at, hopefully, global standards to regulating OTC derivatives and a -- considering a domestic framework for regulating OTC derivatives, that if each one of the panelists could talk about what you see as the advantages and disadvantages to bifurcating the jurisdiction of OTC derivatives or what we need to make sure we get right.

PROFESSOR COFFEE: I don't know why I'm being led to go over the cliff first, but I think the ideal world would be if the two agencies could come to a reasonable memorandum of understanding. I have heard there has been progress in this direction and if you are able to decide that certain kinds of over-the-counter derivatives are -- essentially relate to securities and should principally go to one agency and others don't relate principally to securities and should go to the other, that could be a very commonsense division. It probably should be embodied in a formal memorandum of understanding going back to the original one that separated the two agencies 25 years ago.

I still think that there should be a joint task force because we're really dealing with a strange market when we talk about swaps, but there are only about a dozen big players. And if you learn something about one bank under one agency's ballpark, it should be transferred immediately to the other and you should think together about what more you want to know. But I do think you could come up with a memorandum of understanding that divided this field. I just do not think Congress wants to give all of this to one agency or the other.

MR. RAISLER: Yeah, if I could weigh in here. I mean, I think that my written testimony and my oral testimony this morning focused on the concept of a primary regulator, really picking up on Chairman Gensler's comments to Congress on the treasury bill. I really think that that demarcation is important. The idea of joint investigations of the two agencies sounds laudable, but in my experience, it's quite inefficient. It uses resources of both agencies and it requires, in addition to everything else, a level of coordination, which uses up the valuable time and staffing.

So I mean, obviously, I agree with what has been stated here. There will be some marginal issues at the edges where the agencies have to come together and rationalize them. I also agree with Professor Coffee there needs to be a sharing of information. So if you see something with respect to a particular firm sale of security-based swaps that should be alerted to the -- because that same firm may be selling non-securities-based swaps under the CFTC's jurisdiction. I think all of this is imminently doable. I think it -- you know, there is clearly a culture shift and I think it's a question of leadership, but it's imminently doable in my opinion.

MR. SILVERS: Just to -- I mean, I appreciate your taking up this theme, obviously.

The critical question is to ensure that in the -- that the substantive principals and the agency jurisdiction that apply to the regulation of derivatives are the same as the underlying asset that the derivative references. If that doesn't happen, then you are just buying the events of the last 24 months again.

The problem is what happens since you have been dealt a hand, so to speak, of being two different agencies regulating markets that are increasingly integrated and that the dividing line that historically has been drawn between the Commission, between the two commissions, actually is not, in our view, the sensible one, or that you have products that are under CFTC jurisdiction that are clearly financial -- that are financial products.

Given all of that, you have a boundary problem and it's clear to me that there is a -- that the market participants would like to continue to arbitrage that boundary. I think you've heard words said to that effect today. And if you allow that, that boundary, it's like continental drift. That boundary will separate and there will be an empty space in between and it will be played back and forth.

One way of mitigating that problem is to ensure that it is harmonized in an upward way, the powers and protections under both schemes more comprehensibly. And a fair amount of my written testimony was devoted to those issues, and I think you've heard from Professor Coffee on some of those questions as well.

MR. McLUCAS: I actually think the issue is not one that is the primary concern of these two agencies. In a sense, it really is, whether it's CDOs, swaps, derivatives, the broader problem that these agencies seem to be getting some blame for is systemic risk. And the question is getting a window on systemic risk and understanding it. And I think that the challenge is going to be how do we come up with a system where a window on that risk is available.

Two years ago, I heard someone say that the issue with derivatives, whether there ought to be regulation, derivatives have provided the movement -- the ability for capital to move across borders with the maximum efficiency, minimum of cost and absolutely no need for further government regulation. We will have bumps in the road, we will have some market participants stumble, and there will be losses, but they will be limited because the self-interested nature and the sophistication of the participants will be a policing mechanism in the market.

That obviously was a miss, a huge miss, and I think the challenge, when we talk about this issue, is not really the one of who is going to enforce what standards. It really is windows on the market, from a broader perspective, so we can assess systemic risk and somebody can be thinking about what that requires.

CHAIRMAN SCHAPIRO: Commissioner Aguilar.

COMMISSIONER AGUILAR: (Away from mike.) As long as I say something you agree with, I can use your mike. Anybody else have another mike?

(Laughter.)

COMMISSIONER AGUILAR: Let me be brief, if I can, because I'm mindful of the time and realize people need their coffee break and there are a lot of things that have been discussed that are of keen interest to me from the standard of care of those who give investment advice. Like Commissioner Walter, I've been very outspoken about the benefits of fiduciary standards and would like to see it broadly applied.

I also would dearly love to explore the primary regulator concept, which also came up yesterday and I hope the next panel may give us a chance. I have a lot of questions about how and who makes that determination and what factors are considered. Is it based on revenues? Is it based on the costs that you put into the business? Is it based on what you really want your business to be or based on what -- who you want your regulator to be? And those issues, I think, are worthy of serious exploration.

But let me ask a question more focused on enforcement and in particular, your thoughts on the role of states with respect to enforcement. And even though we're talking about the SEC and the CFTC being harmonized, there's another group of people out there that are also looking for -- to bring justice into the world when people are cheated and deprived of assets.

And while I agree with Professor Coffee that there's going to have to be some legislation down the road to address many of the issues, I would love to get the panel's views as to whether this is one area that maybe require some look-see. I am aware that some commodities legislation restricts the abilities of some states in this area and I would just love to have your thoughts on that just one issue and then move it on to Commissioner Chilton for follow-ups.

MR. ROTH: Yeah. I don't believe there's anything in the Commodity Exchange Act that limits the authority of the state to bring criminal prosecution for fraud. In our experience what happens is, we've, and along with the CFTC, have worked really very hard in developing relationships with federal prosecutors around the country. And what you have to overcome is the eyes glaze over response when you start talking about a violation of Commodity Exchange Act and commodities fraud.

You can overcome that, and we have overcome that, but when you start dealing with the states, you start from square one. And I know, I was thinking the other day, that on our end of the NFA, we need to do a lot better job of working with the state criminal enforcement authorities to educate them a little bit and to demystify some of these prosecutions. I think we've made progress with the federal prosecutors. We haven't done as much with the states and that's a bad on us.

MR. McLUCAS: This is a tough one because I have clients.

In a perfect world, I think if you stood back and looked at this system, you would say this is crazy. We have a state attorney general or state securities commissioner in Iowa making decisions that implicate serious global consequences for a global financial services firm. And anyone who denies that there has been a competitive drive towards escalating penalties and consequences and press releases and cases hasn't been reading the newspaper for the last five years.

I think that it's a system that evolved because, frankly, there were gaps in the degree to which, at the federal level, we were hitting all of the issues, bringing all the cases we could have, and hitting the program areas where there were some serious problems. The result of some of the successes in a variety of the states by state attorney generals and securities commissions means that we've had a competition.

People who see this as good for consumers and investors would say it's a great thing; it's a fail safe system. I think if you take a broader view and step back, you cannot suggest that some of the state attorney generals and securities commissioners haven't found serious problems and done a good job. Is that a good thing for the system? I don't think so.

I think if we did a better job and we had a more sound level of enforcement at the federal level, there is a role for the state attorney generals and the securities commissions. I believe that the level of competition and the level of overlap in the enforcement at a macro -- from a macro perspective is not necessarily long-term, good for the markets or good for investors.

And having said that, I will tell you, you have to give the state regulators their due because they've accomplished a lot. They have identified problems that perhaps would have otherwise been missed. They have been very successful in advancing a number of investor-friendly and consumer-friendly initiatives. But if you were designing a system and you're looking at global competitiveness and you're looking at efficiencies for investors and burdens on an industry, I don't think you would design one that is the current mix as we do today.

PROFESSOR COFFEE: I have to be the real radical in this panel and say over the last 10 years, it looks like competition is a good thing. We're talking about the states. It's really particularly New York State where I work, and the New York State attorney general, through different attorney generals, did discover problems with securities analysts, really did detect the market-timing fraud, which I think was seriously under attended to by the Securities and Exchange Commission, and there have been more recent areas as well. The auction rate securities again was first to state regulators.

I think that there is some desirability because there is always the danger that if one agency has a monopoly on enforcement, it may live the quiet life. Sometimes it may even get captured or semi-captured. There are excesses and I have a current article in the Virginia Law Review that suggests that you could put in legislation that the regulatory agency, whether it's the SEC or the CFTC, should have the power to preempt certain remedies.

If the New York attorney general, as at one point it wanted to do, was going to demand in a settlement that all securities analysts move out of integrated broker-dealer firms and be employed in separate boutiques, I think that was regulating the entire country from one state. And that danger of balkanized remedies, I think, would be excessive.

But I think in general, detection and enforcement, the more the better. It's only when we get to the idea of structural remedies where we can't have one jurisdiction imposing its law on all 50 states. So again, I think that we want competition and enforcement and detection, but there could be problems when structural remedies are designed by one state that override what would be the views of the primary federal regulator. I think that's the one area where there should be some concern.

MR. SILVERS: I strongly agree with what Jack said, but I want to put a strategic gloss on it. This issue often is raised in the context of international competitiveness, and it is true that there is no Martin Act in the United Kingdom, that the sheriff of one county or another can't enforce their investor protection laws.

The system we have with the strong fail safe, as Bill put it, is built -- is designed around a strategy to have our markets have a level of integrity and investor confidence of the global markets hopefully that for our sake do not have to be able to have, as a result of lower cost of capital available through issuing in our markets. This structure, this federal structure, I think is a key element in that strategy.

It may be very uncomfortable at certain moments for people who are trying to do their jobs at the federal government level, this federal system, but it's critical. But I think there is an interesting, also, other aspect of this, in that we didn't see states have had these powers throughout the modern era and yet we -- you really didn't see states stepping forward and asserting themselves until this sort of climax of federal level deregulation and soft enforcement that we saw in the last decade.

If we got the federal regulatory system right, you might see states retreating a bit, but it would be very, very dangerous to cut off the possibility that if the feds failed, they could again advance.

CHAIRMAN SCHAPIRO: Thank you.

Commissioner Chilton?

COMMISSIONER CHILTON: Thank you. Being down at this end of the table, it reminds of that Tom Petty song, you know, the waiting. The waiting is the hardest part. But he said it was a very optimistic song. So I'll think that I've had the benefit of hearing everybody before we get to it at this end.

I want to make a comment. Professor Coffee talked about swaps and we have a very deep bench on swaps at the CFTC. A majority of our investigations are actually on swaps. And so we have, I think, a real expertise in that area. I also wanted to talk, just briefly, about something that Commissioner Aguilar talked about, about criminal authority, and I would be pleased to have Mr. Raisler and Mr. Roth comment for the record on this.

But I know the issues. I've had a dialogue with Attorney General Holder on this issue. And, you know, the argument is, they're the Executive Branch; ergo, we're not. We heard that again yesterday from a witness, but unless there's been a new civics book that has been written, we are still part of the Executive Branch too. We're an independent agency, but we're not the judicial branch; we're not the legislative branch.

The other argument is, well, it's never been done before. You've never given an independent agency criminal authority. That's not a very persuasive argument to me, and I seem to recall something about change. So again, I would be pleased to have people comment for the record. The House Agriculture Committee passed this provision granting the CFTC criminal authority, not the SEC, earlier this year, bipartisan basis.

It has broad support among many groups propelled, I think, by consumer advocacy groups, as we heard yesterday and as we heard at one of our hearings in August. So I helped it go forward and I'll keep fighting for it. I think it will make us a more efficient and effective government, and I think it will have the deterrent effect upon crooks, or potential crooks, who are ripping off folks or plan to rip off folks. And that's particularly important, maybe now more than ever, with the Ponzimonium that's going on out there and all the scams that are taking place, manipulation, et cetera.

So my question, and this is really for Mr. Roth -- it's a two-fold question, but I'll put it out there, Dan, and let you ask, is, would it be more customer protective, as Professor Coffee recommended in his third point, to deal with a higher suitability standard, particularly as we're looking at forex, more similar to the SEC's standard.

And the second part of the question is something we've talked about a little bit yesterday, and some today, is also with regard to possibly altering our manipulation standard to be more similar, maybe not identical, to the reckless standard that the SEC has as opposed to our mandate to prove intent.

MR. ROTH: With respect to the forex suitability issues, as I've mentioned in my testimony, that with respect to retail customers, I'm very satisfied that our approach to that issue is entirely comparable with what the -- is in place in the securities industry. I think there are possible refinements to our rules, but when we're talking about retail customers, I think our rule achieves that effect, and it certainly applies to the forex activities by registered firms. The problem, as I mentioned, isn't the registered firms, it's the unregistered firms, and it's those regulatory gaps that we talked about.

So on suitability, I think there is not a rule in our book that we are not going to -- that we don't revisit from time to time and try to refine and improve and it's certainly true of our Rule 230 as well. But in the specific question that you asked with respect to retail forex, this rule works pretty well for us.

COMMISSIONER CHILTON: And Dan, did you want to comment on manipulation or you would rather not?

MR. ROTH: Manipulation. I'm fully aware of just how difficult it is to prosecute those cases and I'm thankful that we don't have to do it. But the -- I would just be -- I have trepidation. If we're talking about criminal activity, which can deprive someone of their livelihood or of their liberty, the mens rea is a pretty important element. I think there may be a useful distinction between civil and criminal, but I'm very sensitive and sympathetic for the difficulty of prosecuting those cases. And anything we could do that would help that I think would be a good move.

COMMISSIONER CHILTON: Okay. And since it appears I have unlimited time, I'll ask for just one more.

I know I don't, Madam Chairman.

But Professor Coffee you also got to something I thought you were going to get to when you were talking about funds that do research and place -- and make trades based upon that. We talked about this at one of the hearings we had last month. The chairman was really eloquent, Chairman Gensler was really eloquent in asking about this. And that involves the firm's ability that their research arm does this work.

And it's one thing if they use it for their internal trading practices, but when they put it out to the public and it has the potential to move markets, is that an issue. Should, as some have suggested, there be a requirement that the research arms, who publish data -- say, for example, crude oil is going to be $200 and then the price of crude oil goes up the next day -- should that be separate from the actual trading arms of such a firm.

PROFESSOR COFFEE: Well, this is a problem that has kind of settled on the securities loss side as well. There were a number of press stories recently about whether or not Goldman Sachs was trading on information that it put out to the market. There is, under FINRA, an obligation to treat your customers equally. And there could be conceivable problems when you are giving some information to some of your customers and not to others. That's not insider trading. That's sort of this equal obligation to treat all customers equally.

Otherwise, the only time I would see a problem in these statements you release to the market is if you were behaving inconsistently with them. If you are saying buy in your research and you're selling a proprietary desk, that does raise some questions about whether you were pumping the market. I don't know that that would be true in any case. That's, again, not so much insider trading as it is a false statement that you don't believe that you might be making to the market. So there are subtle gradations there, and I don't want to take more time on this, but I think this is something a little bit different than insider trading.

COMMISSIONER CHILTON: Okay. Thank you, sir.

CHAIRMAN SCHAPIRO: Thank you.

Commissioner Paredes.

COMMISSIONER PAREDES: Thank you. When it comes to enforcement, we really have a process of enforcement. You start with the laws on the books and the jurisprudence which fleshes it out over time. You then have the challenge of detection and investigation. And of course, even if you detect, after the investigation and the ongoing investigation, you still have the challenge, as regulators, of successfully bringing the case to resolution.

All of that takes an incredible amount of resources. And we can talk about it in terms of technology, computer wherewithal and all the rest, but of course, it takes human beings at every step along the way. And we are both agencies that have limited resources. And even if there are increases in resources, there will still be limited resources. It will just be a somewhat different constraint.

So what that then means is, is how do you most effectively allocate those resources. And so given the challenges that we have, given the experience over the last couple of years, given what you all see on a going forward basis, given your perspective and take and experiences, recommendations for priorities, for how to allocate the resources in the most efficient and effective way -- and we probably don't have time for everybody to take a swipe at it, but perhaps, Bill McLucas, you could start and then maybe a couple of others could chime in with any thoughts they have on the question of resource allocation and priorities.

MR. McLUCAS: Yeah. Let me start on a process issue -- and I think Chairman Schapiro alluded to this -- that the level of access to technology and the capacity to use technology is enormous. The staff has made incredible strides. The burden now on this side of the table to comply with the request in format, in style and ability to allow searchable information have increased dramatically, which means that the staff's capacity and capability and expertise has escalated dramatically. I mean, from a defense lawyer's perspective, e-mail is the destruction of western civilization, but that's a very different issue.

In terms of priorities, I mean, I -- you look at what happened in the last 24 months in the, I think, early pronouncements we were hearing coming from Capitol Hill, the demands and some of the statements coming out of the government were that we're going to go out and we are going to find the people who did this and we're going to prosecute them.

What happened to us in the last couple of years was a systemic failure that involved a lot of people missing a lot of issues and a market dynamic that we've never seen before. Some blame can be laid to rest at the feet of a lot of people and I'm not sure that all of it -- there will be cases, and there are cases to be brought. But I don't think the enforcement response is really the answer to that bigger question.

I think that in terms of looking at where you put your enforcement dollar, it's really a question of looking at the issues in the system where you think we have the biggest risk and figuring out how to access market intelligence to identify things that we ought to be ahead of. The challenge there, from my perspective, is the system doesn't allow this agency or the CFTC to take enough advantage of the expertise and knowledge and cutting edge thought that emerges from the industry. And there's a risk there.

But the most sophisticated derivatives traders and people that were on the cutting edge of what was happening in the market were people who were doing things that were years removed from where we were going to get, where the government was going to get, because we don't have a window on it. Finding a way to bridge that gap, whether it's consultants, whether it's managing the ethical issues and challenges that poses and some of those barriers I think would be a help.

I think it would be ideal for this agency to bring in 10 or 5 or 8 of the smartest people you could get on macro market risk assessment for a year or two. Do whatever we have got to do to jump through hoops on ethical issues, but get their thinking about what we ought to be worrying about 36 months out in the marketplace. And I think that the system hasn't allowed that, but it is an idea that would be worth pursuing.

One of the other issues, and I'll say it, but it's a -- and it's a sensitive issue, but I'll say it anyway. I worry today, in the climate we're in -- we have the Madoff report that has just been issued -- you bring in people and you pay them a fraction of what they can -- at least what they used to be able to make in the private sector -- the marketplace today is a little different. But we're paying people to make decisions. And when I was the director of Enforcement, I can tell you I don't think there was a day that I didn't wonder to myself did we miss something today. Did somebody do something they shouldn't have done. What did we fail to pick up on.

And the risk that I see in the climate we're in, is we are -- we have got to be careful that we don't create a decision adversity by the staff people who make a dozen decisions a week to close cases, to bring cases, to get that extra witness, to do the extra five things.

My sense right now, from where I sit, is that we have a mentality on the staff of fear of being second-guessed, of missing a case, of not suing a defendant, of not pursuing a theory, that has the agency potentially wasting enormous numbers of staff hours and resources because we have a staff that is living with a level of trepidation and fear about being second-guessed because they didn't take that last step and by God, they don't want to be identified in the next inspector general report.

Now that's probably beyond what I'm supposed to be talking about here, but I will tell you, it is a perception I have and it is a fear I have as I look at the staff and at the institution and what we ought to be thinking about in how we manage our enforcement resources today.

MR. RAISLER: Two quick observations, I think. First, you know, it seems likely, and I think a lot of people recognize the benefits of the agencies getting increased authority with respect to the OTC markets, and I think it's important today to start planning for that. Whether that's the technology on the surveillance side, but also what it means to have that authority and how to implement it. So I think, you know, that's today in front of you.

The other thing I would say is picking up a little bit on what Bill said, there are -- there is talent out there in the marketplace that has never been available to the agencies to hire who have direct trading experience, who have either been laid off or are disaffected with the Wall Street environment, who can, I think, bring insights that the agency has not heard before. Not the five to ten people that Bill is talking about at the highest level, but actually bringing people on at the staff level who will be willing to pursue actively looking at the market and having the intelligence of having been on the other side.

I think for the longest time the agencies have not hired people with experience because of the economics, as well as the perception issues associated with it. I think that has changed. So I would hope that the agencies could actively pursue, particularly as budgets increase, a caliber of participant in the market who could help you have a little bit of a window into second-guessing what's going on or perhaps predicting what might be ahead.

CHAIRMAN SCHAPIRO: Very quickly. I am such a bad time manager. We are so far over time.

MR. SILVERS: And you're dealing with such short-winded people.

(Laughter.)

MR. SILVERS: Two points. One is the Commission, and I assume the CFTC, has always wrestled with, on the one hand, sort of outright -- sort of criminal or quasi-criminal element in the marketplace and on the other hand, the systemically significant case. The -- I think the events over the last two years really put an exclamation point on the notion that there needs to be a managerial strategy for ensuring that adequate resources are devoted to the systemically significant cases, not just in enforcement, but in areas like CorpFin.

I mean, how much would the company -- would the country have benefitted from a really heavy duty line-by-line analysis of the three major banks that still can't return their TARP money, if someone had looked very, very closely at their financial statements in 2005, '6 and '7. Of course, you can't let the criminal element just run loose, right? So you have to have a real managerial strategy for going after those folks, but keeping heavy resources focused on those systemically significant issues.

Secondly, I cannot resist, after listening to Bill talk about pressures on Enforcement staff to make the extra phone call -- one of you referenced the fact that you work for the public. I think the public would be overwhelmingly gratified to learn that the Enforcement staff are under pressure to make the next phone call.

CHAIRMAN SCHAPIRO: Thank you.

Chairman Gensler.

CHAIRMAN GENSLER: Thank you, Chairman Schapiro. I promise I'm going to have a question at the end of this, but it will only be Damon and Jack. All right? But I had a comment on each of what you had said. I want to first thank Commissioner Chilton. Flattery is a nice thing. That's good.

Dan, I want to associate myself with what you said about ethics retail. I think we have to do a lot more not only on the foreign retail exchange retail -- the Administration was very kind to us in putting that in the administration bill -- but I think there is even more. We need to fix the donor zoner issues that you referred to.

David, I feel badly you are on a panel with a lot of long-spoken people.

MR. DOWNEY: How do you think I feel?

(Laughter.)

CHAIRMAN GENSLER: Yeah, yeah, yeah. But I do have a question if you could follow-up and help both of the commissions. You could go through the last number of years at your exchange and how many new products you've had, how many you've successfully brought year-by-year and how many you actually had to seek. This product, this goal is important, but how many actually successively went through. How many took six months or two years. It would just be good to get context in this whole regard.

The Administration was also kind and set up strengthening the CFTC's oversight of exchanges because we agree with what was said, I think, by Damon in his written testimony, that we need to strengthen and should not have to bring into the courts if we think the exchanges have not lived with the core principals. And in fact, it gives us 10 working days to decide whether something is material or 90 days to decide whether we agree with a rule or a new product. So it does have deadlines, but it strengthens it.

Ken, I can't thank you enough for saying we're under-resourced. This agency, the CFTC, is sorely under-resourced. We just had the headcount we had in 1974. We finally got back to where were in 1999 and the volumes have gone up five-fold; contract volumes has gone up six-fold. I would say the same thing about the SEC, just unfamiliar with their numbers.

I wanted to say on joint rules, we, under the derivatives legislation, want joint rule-making with the SEC. We have sought it. It's going to be hard. It's going to be problematic. It's not easy. But in terms of this primary regulator thing where you keep quoting me, it would be joint rules between the SEC and CFTC.

MR. RAISLER: And actually, I think that could work as long as the rule --

CHAIRMAN GENSLER: Yeah. My time. It wasn't a question.

(Laughter.)

CHAIRMAN GENSLER: Bill, I just wanted to mention we have a great President right now and he likes Iowa a lot. I don't think you're going to be running for office in Iowa anytime soon, but Mike Dunn, also, can tell you about all about Iowa because he still has a home there and he's from Iowa.

MR. McLUCAS: Not a question either I take it.

CHAIRMAN GENSLER: No, but if you want to declare your candidacy, you can right here.

Damon, I think what we've done jointly with the SEC on trying to cover the derivatives area -- I couldn't agree more with associating with your comments on that we've got to cover that whole world. And I believe, as you said, that we should not have exceptions or exemptions. But it's going to be tough because Bill has said, "Look, we are going to need people to look around corners. Five and ten years from now there will be new products and we might have to go back to Congress to get more new authorities as well."

Richard, you talked about working together. Right now one-third of our enforcement actions at the CFTC are brought jointly with the SEC. There's a lot that works between these two agencies and work very well between these two agencies.

I feel committed. I think all nine of us -- or, wait. No, there's more? No, nine of us here feel committed to working jointly. I know what Mary and I have already done. We've had three times we've testified to Congress together. We don't agree on everything, but we agree on an awful lot here and I think we're trying to make our differences narrow because it is important to go to Congress with a unified agenda between these two agencies. And that's what we are clearly trying to do.

Jack, I want to associate myself with your comments. I believe the federal system benefits investors, that if we have dual enforcement -- there might be times of excess, but net, net, on balance, it's a huge benefit to the American public. So here's my question. It's on manipulation. Commissioners Chilton, I think Commissioner Aguilar sort of were asking about it too. Manipulation standards. I've never went to law school. So I get a little confused here.

The CFTC currently has a specific intent standard. Maybe it comes from comp., you know, the case law. And there are a number of advocates, of very strong advocates, that we should have a difference standard. Only once in our history have we actually proven one of these cases in court.

Senator Cantwell, I think, has been a real advocate and I applaud her in trying to get the FERC and the FTC, which was referred to earlier by Ken, to have a more SEC recklessness standard. So can you help us here as to the benefits of a recklessness standard, rather than specific intent, and in this case, really about the cases we bring, about congestion, about manipulation squeezes congestion and market practices as opposed to the sort of more classic SEC cases.

PROFESSOR COFFEE: I realize this whole room must give a succinct answer. So I will try and do that.

The elements of market manipulation require that you show that there was an intent to execute a squeeze or corner. That's more than just I was thinking the market price was going up and I could push it up higher by making this huge order. It's an intent to execute a squeeze or corner.

You could simplify that, move it down to a recklessness standard that there was not an appropriate purpose underlying your trades like hedging. You'll get a lot of push-back on that; this won't be done without a lot of opposition. But that element could be simplified. My basic suggestion to you was that you should use alternative remedies that are prophylactic and forward --

CHAIRMAN GENSLER: I know we have very little time. I get the position limit thing. We had three full days of hearings on that, but would a recklessness standard actually be able -- could we use that in court?

PROFESSOR COFFEE: Yes. You could -- it is not just recklessness. It's getting out of the element the intent to execute a squeeze or a corner and making it something simpler.

MR. SILVERS: And very simply to add to what Jack said, proving intent in court, particularly against competent defense counsel, is very, very difficult unless someone is foolish enough, per Bill's comment, to write the e-mail that says, "Wouldn't it be great if we could achieve a squeeze or a corner today." You know, once in a while, people do that. I gather once in the history of the CFTC somebody, you know, somebody wrote down their intentions. People almost never do that.

CHAIRMAN GENSLER: Well, I would like to hear more about it. I've certainly -- I've had a lot of discussions with our head of Enforcement and our general counsel in how we can -- I believe that the CFTC needs to strengthen its ability to police these markets and bring manipulation cases. I'm just not quite sure how we do it, but I think we have to do it.

CHAIRMAN SCHAPIRO: Thank you. Let me thank this panel. You've been so generous with your time. We've kept you almost twice as long as we said we would and your thoughts have been so instructive for us. So thank you all very much.

I think we will take literally a three-minute break because we are so far behind schedule. Just long enough to change the nameplates and then ask the next panel to come up. So again, thank you very much.

(A brief recess was taken.)

PANEL TWO - INVESTMENT FUNDS

CHAIRMAN SCHAPIRO: If everybody could take their seats, I think we'll go ahead and try to get started.

CHAIRMAN GENSLER: I think I'm supposed to call it back to -- in order and I would note that the SEC chair and the CFTC chair have -- I don't know whose glasses I have now. So this is --

CHAIRMAN SCHAPIRO: We're so harmonized.

CHAIRMAN GENSLER: -- definitely harmonization.

CHAIRMAN SCHAPIRO: We're so harmonized, we're sharing reading glasses.

CHAIRMAN GENSLER: I don't know.

CHAIRMAN SCHAPIRO: I don't know either.

CHAIRMAN GENSLER: I don't know. All right. There you have it. We've achieved the President's goal a little bit.

We are going to take statements. I'm supposed to introduce the panelists. We have Richard Baker from the Managed Funds Association. I would note, Richard, the last time we were in a hearing room together, you were chairing it and I was a witness and that was quite a lively hearing. I don't know if we can say the same will be today as that was on systemic risk and the mortgage markets. But Richard is now here with the Managed Funds Association.

Sharon Brown Hruska, a former chair of the CFTC -- good to see you, Sharon -- and is currently with NERA Economic Consulting.

Kathleen -- we've swapped the orders, but Kathleen Moriarty with, is it, Katten Muchin Rosenman?

Now which order do we have. All right. Back here. Michael Butowsky with Mayer Brown.

And Michael Connolly, Association of Financial Professionals.

And I gather I go first with asking questions.

CHAIRMAN SCHAPIRO: Yeah, take statements.

CHAIRMAN GENSLER: Or statements. Great.

MR. BAKER: Thank you to both the Chairs and to the Commissioners for affording this opportunity to be heard. Our association represents professionals who manage and advise hedge funds, funds of funds and manage futures as well as a significant number of other industry service providers.

The discussion around the new regulatory framework should have, as a principal focus, ensuring efficient oversight while preserving the integrity of market function for the benefit of the investor. That statement encompasses a broad array of responsibilities across the entirety for market participants. For example, advisers should be registered with either the SEC or CFTC and not be required to comport with duplicative registration, unless the adviser has a significant level of activity in the associated jurisdiction.

We do support registration of all investment advisers to private pools of capital with a modest exemption for those who have a de minimis level of assets under management; however, there will be occasion for advisers to be registered with both. In such case, every effort should be made to have regulatory harmonization. Duplication of regulatory efforts serves no one well and diminishes resources that could be put to better public service. In limited instances, regulatory requirements conflict and make compliance efforts difficult if not impossible.

One example is seen in the area of reporting performance data where the agencies have differing standards as to the use of hypothetical performance data relative to the use of related performance data. I have more detail on this concern in my written statement.

Audits can be made more productive by coordinating efforts in the sharing of information. For example, the establishment of the joint use internal database to share registration and examination information among appropriate regulatory authorities would save considerable time and effort on the regulatory side and provide the opportunity for the most efficient examination process for the registrant.

There should be, and it would be a significant effort, I realize from the preceding discussion, for the CFTC, the SEC, NFA and FINRA to examine and evaluate the necessity for and public value of redundant standards of oversight. To that end, we support the establishment of a joint investor advisory committee.

To digress a bit, much in the same tone that this hearing was convened where you solicited opinion from individual representatives in the market, to have this institutionalized as a more permanent method of communication, have it composed of investors and the sponsors of investment vehicles, the traded securities and futures, to provide the Commission with direct and honest insight into the investors' concerns, this could enable the CFTC and the SEC to move more effectively in providing coordination.

I take note of the discussion relative to historical concerns about staff perspectives. Having market participants in the room with the staff in those discussions I would believe would be very helpful in moving the decision process forward.

With regard to regulation of OTC derivatives world, we understand that Congress and the Administration are imposing significant changes in the requirements. We understand that the lack of insight into this important function requires enhanced disclosure. We encourage the agencies to coordinate registration requirements and regulation of systemically significant participants through the use of a central electronic database, not only for registration but for coordinating audit and examination functions.

There is need for regulation that treats similar products in the same regulatory manner. For example, a single security CDS should not receive different treatment from a CDS index. The two are deployed interchangeably for hedging purposes and daily market function; however, I wish to make clear that different asset classes have varying performance and risk metrics and therefore, should be regulated differently. From foreign exchange to equity and credit, each asset class had its own characteristics that require differing regulatory treatment.

When it's possible to move plain vanilla standardized products to exchange traded, that is understandable, but there are many steps, we believe, needed to make that happen. Moving standardized to a central clearing system may be achievable on a much more accessible timetable and would yield much of the same benefit.

We also support requiring all market participants to post margin, or other appropriate collateral, while ensuring that such collateral is segregated and protected in the case of default. Maintaining the ability to trade non-standard contracts without impairment is essential to market function. Reporting of these contracts to a central trade repository, however, would provide regulators, we believe, with the essential insight as to market conduct while not impairing efficient market function.

Therefore, we support moving as much of the OTC derivatives trades to standardized while observing there is great need for the non-standardized. In today's economy, disclosure to a central trade repository of the non-standardized trade gets the critical information to regulators, while enabling this essential economic function to continue. I appreciate the effort to be -- the opportunity to be here and look forward to your questions.

CHAIRMAN GENSLER: And I appreciate somebody who served on House Financial Services and made it inside their clock.

MR. BAKER: I understand the five minute rule.

CHAIRMAN GENSLER: Yeah, you do. That's good.

Sharon.

MS. BROWN-HRUSKA: Well, thank you, Chairman Schapiro, Chairman Gensler and Commissioners. It's such a pleasure to have an opportunity to address you today and submit testimony on the topic of regulatory harmonization. I've had the privilege of serving and working with -- working for some of you here today and my respect and regard for the important work you're doing really can't be overstated.

The goal of regulatory harmonization is a desire that has been known to us all for quite some time and President Obama has pushed for the two Commissions to roll up their sleeves and come to terms with institutional and statutory differences, and their competing interests and their competing constituencies is most welcome.

In the interest of efficiencies, some of the substance of my remarks today come from articles I've written, and I will provide them to you. At NERA, we pride ourselves on objectivity and independence in our economic thinking and analysis and but I do want to mention that these are my views and not necessarily those of NERA.

We find ourselves at a pivotal point in defining the shape and scope of derivatives regulation. In the aftermath of a numbing liquidity and credit crisis, prudence dictates that we examine the causes of that crisis and the regulatory gaps and deficiencies that may have prevented it. You are now looked at as the stewards of this important marketplace, a market that exists so that the very risks that become stark and scary in the credit crisis could be assessed and managed.

It is my view that addressing credit and systemic risk concerns by wholesale restructuring of the OTC derivatives markets and by altering their well-developed mechanisms for contracting and risk mitigation, goes beyond what is required to address counterparty and systemic risk concerns.

But I'm going to focus my testimony just on a couple of areas where I believe the costs of taking one approach or another need to be considered. First, I just raised the precedence of the private contracting markets and how this construct, which exists in the Securities and Exchange Act, Investment Advisers Act and the Commodity Exchange Act enables businesses to access capital efficiently and efficiently shift risk to investors willing to bear it.

In my view, the securities laws designed for the protection of retail investors may not be that well applied to derivatives. And so I -- and also I think that they may have economic disincentives that have contributed to the issuance of equity in foreign markets, alternative look-alike products that have developed which have been a concern to us all, and the growth of foreign-domiciled funds.

And that leads me to conclude that certain mandates, if they are adopted in the OTC derivatives markets, could really raise the cost of businesses of hedging and that -- and also the markets will contract and eventually move overseas. But I do agree firmly that efforts to intelligently regulate significant players under a principals-based regime with enhanced information and more staff needs to focus on efforts to harmonize regulation.

While they are exempted or excluded from provisions of the securities and futures law right now, the CFTC and SEC have enforcement authority to exercise and enforce their federal anti-fraud and anti-manipulation authority to OTC derivatives. I think it's great to provide the agencies with additional surveillance authorities and access to position level information in the OTC markets. I think it's essential.

But in this regard, it's important to remember that while Congress did not let the OTC markets off the hook when it comes to fraud and abuse, they recognize that inserting regulators between sophisticated entities in their negotiation of private contracts is not cost effective and poses some moral hazards for the agencies. But I did like the point that was made this morning, which is it's about systemic risk. And that's where you're absolutely, I think, justified in looking at how we can regulate OTC derivatives more, you know, more forcefully. And I support that effort.

One area I just want to raise to you, and you can read about it in my submitted remarks, many proposals seek to standardize OTC derivatives contracts. Many commercial users of the derivatives, OTC derivatives, have stated to me, and in a lot of engagements where I've been speaking, that they think the loss of customization and the flexibility that they've come to expect in the OTC products will raise the cost of hedging in using derivatives contracts.

If they are unable to hedge in a cost-effective manner, they'll experience greater volatility in their cash flows and thus, in their balance sheets. This volatility makes it harder to plan for the future and makes efficient resource allocation more tenuous. In short, discouraging OTC contracting will make it harder and more costly for business.

I've also got some remarks about margin and I agree very much with that as well, that we need to look at increasing margin requirements, maintenance margin requirements for OTC derivatives. I'm going to skip that in the interest of time and just get onto a couple of other things that I want to just quickly point out.

CHAIRMAN GENSLER: Just because your red light -- if you would help us just summarize just to --

MS. BROWN-HRUSKA: Okay. Well, I just -- one other area, which I've been concerned about, is discussions of a ban on CDS short positions and naked CDS. I think that that -- derivatives markets are, you know, going short and going long are as legitimate as the other and it's very vital to the liquidity of the market.

And I also just wanted to comment on something you raised yesterday, which is this issue of fungibility. And I hope that, you know, that you will look into that and think about other ways -- there are actually other ways, from a market structure perspective, like exchange of futures for futures or -- that I've done some research on and that I think would introduce competition into the markets short of fungibility. So hopefully we'll get a chance to talk about that some more.

CHAIRMAN GENSLER: Thank you.

Michael. And I hadn't had your testimony. So I don't know if it was submitted late, but if you could submit it for the record, it would be helpful too.

MR. BUTOWSKY: Definitely. It hasn't been submitted yet though. So it's definitely late.

CHAIRMAN GENSLER: But you will be submitting it?

MR. BUTOWSKY: Yes, I will.

CHAIRMAN GENSLER: Okay.

MR. BUTOWSKY: Yeah. Well, thank you for permitting me the opportunity to speak. Kathleen and I, Kathleen Moriarty and I, have both coordinated a little bit here. I'm -- in the hopes that it will be helpful for the Commissioners, I am going to outline a little bit the basic framework for the Advisers Act and the Investment Company Act components relating to private funds and Kathleen is going to pick up on the public funds. And we'll do it all in under a combined 10 minutes.

So very, very briefly, I just wanted to -- this may serve as a good background for some of the questions. For structure, the Advisers Act on the securities side is what I'll focus on. In the private fund world, most people who run private funds, obviously, start out as advisers whether they are registered or not. That's the first basic framework point that I just wanted to mention.

By virtue of that, a significant -- I like to always say about 90 percent of the Advisers Act already applies whether or not you are a registered adviser. And I'll get into a list of a couple of the things that apply, but the vast majority of the elements of the Act already apply whether you're registered or not.

People who run private funds, private equity funds, hedge funds, whatever kind of fund, typically rely on an exemption for advisers that have under 15 clients in any 12 month period for registering and also don't hold themselves out to the public generally as an investment adviser. That's how they typically don't have to register as advisers. There are many bills before Congress right now which may change some of that, but for right now, that's the way it stands.

Okay. So if somebody is a registered adviser or an unregistered adviser, many of the components of the Advisers Act apply already. First, the general anti-fraud provisions apply. So I won't go into too much detail about any of those in the interest of time. But many of them do, including issues relating to principal transactions, and the like, and having to get prior consent on principal transactions.

There is also a rule the SEC passed last year, 20648, that makes it clear that the anti-fraud provisions passed through a fund by an adviser, that obligations relate to the investors in the fund. That's sort of new over the last couple of years, but it was meant to just memorialize the position the staff had already always taken that it had in the first place.

There are -- when you are a registered adviser, the things that apply that don't apply on their face directly to unregistered advisers, number one, is the obligation to have a chief compliance officer, have books and records that are maintained, but on the CCO side, in addition having a compliance manual, and also having exams by the SEC. Those are probably the most prominent things that apply when you're registered.

There is also a rule relating directly to marketing of materials that on its face only applies to registered advisers, but through various releases and footnotes and releases, the staff has made clear that the anti-fraud provisions under the Advisers Act make those rules pretty much applicable, in any event, directly to unregistered advisers as well.

Now in the interest of time, I will just go very briefly over now over to the Investment Company Act element and then turn it over to Kathleen. But under the Investment Company Act, the -- most private fund managers want to try to have their funds not get registered under the Investment Company Act. The Investment Company Act for a private fund, if it uses leverage or anything -- yeah, mostly leverage, but also having the obligation to have disinterested directors and the like can be problematic. At least it can clog up operations for a while.

So many private funds rely on one of two exemptions. One is 3C1, otherwise known as the under 100 person exemption, which is an exemption for private funds that are -- that have under a hundred or fewer beneficial owners of their securities. There is a myriad of no action letters out there that dictate how you count to a hundred. That exemption is premised on the concept, when it was originally adopted, that a fund that has a hundred or fewer beneficial owners is too small to warrant the public interest.

In '97, Congress passed, in connection with NSMIA, it passed into law a new kind of private fund that are qualified purchaser funds under 3C7 of the Investment Company Act, which basically had the premise that rich people are smart and don't need the protection of the '40 Act. And those say that if you have all qualified purchasers in your funds, meaning people -- individuals with five million or more, basically, or 25 million or more, if it's a company, that you can have an unlimited number of investors in your fund.

In the industry, people have limited that to 499 because if you pass 499 investors, the fund would have to register itself under the Exchange Act, but you could conceivably have an unlimited number. And in both instances, the funds have to be privately placed under the '33 Act. And we'll get into -- I hope that is helpful from a framework point of view. And let me turn it over to Kathleen to pick up.

MS. MORIARTY: Well, I was going to say good morning, but it may be good afternoon to the Commissioners and the chairpersons. I'm Kathleen Moriarty; I'm a partner at Katten Muchin Rosenman, which is a law firm, and in the interest of time, I'm going to significantly cut my statement down.

I did submit my statement this morning at 7:00. I don't know whether you have it or not, but --

CHAIRMAN GENSLER: Thank you.

MS. MORIARTY: -- there is a written statement that will explain in more detail what I would like to briefly outline today. I'm also going to deviate a little bit from my presentation that Michael and I discussed because I attended the sessions yesterday and I found that I looked at things in a slightly different way. And so I have an interesting proposal to suggest at the end of this.

The easiest way to describe my practice is to tell you that I represent publicly registered investment companies and exchange traded funds, exchange traded commodities and the like. And because of the increased awareness on the level of retail investors about the benefits of indexing, diversification and alternative investments, there has, as you know, over the past five years or so, arisen a new group of investment vehicles that are deliberately designed to be marketed to retail investors. And these are what I call ETCs or exchange traded commodity funds.

If commodities were defined as securities under the Investment Company Act, which they are not, a pool holding commodities offered to retail investors would be an investment company under the Investment Company Act; however, they are not named among the listed varieties of securities. So therefore, a pool of commodities offered to retail public, let's say traded on an exchange, as contrasted to a pool of securities offered to retail public members traded on an exchange, are regulated differently and are regulated actually by the SEC differently.

The Division of Investment Management regulates the investment company model and a pool vehicle holding commodities or other kinds of assets that are not considered to be investments securities are issued through the Division of Corporate Finance. So there are different registration forms and all kinds of things that flow from the differences between those two.

Thinking about it holistically, which is something as a practitioner I never do because I'm always asked to deal with what the reality is rather than think about what could be, yesterday I started thinking about what could be and it seemed to me if I were going to design, at the outset, a framework for the offering of securities based on pools of assets, pretty much no matter what variety, I would have them all regulated in the same way by the same regulator, and then I would look to the underlying assets to perhaps make suitable differences among them, if necessary.

So in a perfect world, this would be accomplished by legislation that would amend the Investment Company Act to include the definition of securities to include commodities. However, I think that's highly unlikely, probably will never happen in my lifetime. So I decided, trying to put on my creative hat, that there might be a possibility, through the Exemptive Order procedure, under Section 6C, that we might arrive at the same conclusion and regulate both sets of pools under the '40 Act.

I know this will disturb a lot of people, but I strongly believe that the '40 Act, which is a substantive regulatory arrangement, really does provide investor protection and is geared to dealing with the problems and abuses that are unique to pools of money or pools of instruments managed by one group of persons for another group of persons' benefit. And just as securities and commodities are different from each other in some ways, pooled investments are different from regular securities and commodities. Hence, I think they should be regulated by a uniform regulator. I would be happy to take your questions.

MR. CONNOLLY: So good morning. And yes, I think we're still good morning. And Commissioner Chilton, I -- with your comment about the waiting is the hardest part, I can relate.

Chairman Schapiro, Chairman Gensler and Honorable Commissioners, thank you for providing me the opportunity to speak with you on harmonization of over-the-counter derivatives regulation from the perspective of the end users. My name is Mike Connolly. I am vice chairman of the Association for Financial Professionals, as well as the treasurer at Tiffany and Company.

AFP represents over 16,000 financial and treasury professionals from over 5,000 corporations. Our members include a significant number of corporate finance officers, like me, who are responsible for the protection and management of our corporate cash, especially including the hedging of risks to our cash flows, from fluctuations in commodity prices, foreign exchange rates and interest rates, as well as managing both short and long-term debt and the market risk entailed with them.

My employer, Tiffany and Company -- if you're not familiar – was founded in 1837 in New York City, one of America's oldest business institutions. Today Tiffany has a presence in over 50 countries and to support our retail operations, we manufacture, in our U.S. manufacturing facilities, between 55 and 60 percent of everything we sell. Made in America.

As a practical matter, AFP supports the idea of improving the regulation of over-the-counter derivatives market and enhancing cooperation between the CFTC and the SEC; however, we are concerned that reform will be too focused on the exotic and speculative uses of derivatives and as an unintended result, businesses that use derivatives responsibly to contain costs and manage risks may lose the benefit of these critical strategies.

Derivative products are essential risk management tools that financial professionals rely on to help mitigate uncertainty and costs and minimize risks associated with transacting business in foreign currencies, purchasing commodities and managing the cost of capital. The objective of all these activities is to minimize volatility and provide predictability to the underlying transactions they are hedging.

Regardless of the instruments organizations use to manage risk, it is critical that they be able to understand the characteristics and mechanics of each instrument and have certain certainty about the legal and regulatory framework. To that end, we fully support the goal of eliminating jurisdictional uncertainty that exists regarding which agency regulates which instrument.

Large consumers of energy use OTC derivatives to predict their -- to lock in the price of their purchases, American companies doing business overseas use currency derivatives and similarly, Tiffany employs hedge strategies to protect our purchase of raw material costs, foreign exchange translation risk and interest rates. Potentially, these activities could be subject to different jurisdictional authorities, but in the eyes of the financial professional, they are functionally equivalent. A forward is a forward.

In addition to harmonizing the regulation of over-the-counter derivatives, a number of related proposals have been discussed by the Administration, including requiring clearing of standardized OTC derivatives, imposing higher margin requirements and non-standardized over-the-counter derivatives, and imposing record-keeping and reporting requirements.

AFP members who use custom contracts have voiced concern about the ability to satisfy hedge accounting rules with this regulation. Should standardization be required and customization become unwieldy due to mandates from a regulatory agency, the ability to comply with hedge accounting requirements will become difficult, too expensive or just impossible. We cannot stress enough that companies be able to use hedge accounting to avoid distortive volatility and earnings volatility in their financial statements.

AFP understands and support mandatory reporting of over-the-counter transactions; however, it is our belief that the reporting should be done by the major market participant and not the corporate user. Due to the nature of their business, the major market participants are already prepared to report on this. Corporate practitioners don't have the resources and would have to develop the infrastructure to meet any new reporting or monitoring requirements.

On the issue of increasing margin and capital requirements for non-standard over-the-counter derivatives, central clearing typically requires users to post cash or treasuries up-front and even further along in the contract. This amount of capital will tie up the potential to be -- the amount of capital could be significant in restraining other investments. In essence, it could impact our liquidity management.

Companies matching their exposures to over-the-counter derivatives do not pose a systemic risk and should not be subject to onerous regulation. As financial professionals and practitioners of financial risk management, we believe it is critical to preserve the prudent and successful use of over-the-counter derivatives.

Capital is mobile. If required -- requirements for derivatives become too onerous, users may look offshore. We urge you to consider this point as you develop regulation and try to harmonize the regulations globally. We urge you to ensure that harmonizations and regulations -- of regulations and management of a systemic risk posed by over-the-counter derivatives does not come at the cost of proven risk management tools. Thank you for the opportunity to present on the behalf of end users. The AFP and its membership are happy to work with both agencies and answer whatever questions.

CHAIRMAN GENSLER: Thank you. I think I'm going to go first and then pass down to other commissioners.

I do want to say that probably one of the happiest moments of my life was walking into Tiffany's and buying gold rings, which we have successfully worn for 20 years of a wonderful marriage. So I have a soft spot. I don't necessarily agree with all that you said about derivatives, but I do have a very soft spot for Tiffany's.

In terms of derivative legislation, let me just say, I think our joint goal, and the Administration, is that we have to lower risk in the system. Not just systemic risk, but risk in the system and increase efficiency and transparency in the system.

And so I'd look forward beyond this panel discussion to hear more, because the end user concerns are very important. But I think that by increasing transparency tens of thousands of end users benefit, which is, they get tighter spreads and they get better financing and better hedge transactions by benefitting from that transparency.

But I want to focus my questions in my few minutes on commodity pool operators and investment advisors and I really am going to have two questions and I'll say both of them and then panels can deal with the questions.

One is in the area of moving forward with Congress with further registering all investment advisors and hedge funds and so forth. We're supportive at the CFTC, or I can only speak for myself, the other Commissioners may have a different view. But supportive of the Administration view that the SEC get some broad authority to register these investment advisors. So I'd like to hear how you think that can work with the current regime where the CFTC already has over 1,300 commodity pool operators registered with us. Many of the largest hedge funds in the world are registered with us. So that's one question. How can we make this work together, this SEC and CFTC, so that we can still enforce our, be the cop on the beat, and enforce our rules.

My second question relates to exchange traded funds, and particularly as it relates to the commodities field. We have a mandate from Congress to set and enforce position limits in our markets. Some exchange traded funds have come up against those position limits where they have open registrations and, as you know, an exchange traded fund, they have all this redemption process where people come in.

How do we sort of square again the SEC and CFTC? Each have different regimes, they're regulating what are, effectively, commodity pools, but they're also open to the public and hitting up against position limits. So I leave those two questions to, I know Richard will have an answer and maybe somewhere in the middle of the panel, maybe all of you.

MR. BAKER: Thank you, Mr. Chairman. I would say with regard to the investment advisor/commodity pool operator issue, we came at it from the perspective of principally engaged in, and a cafeteria list of other identifiers to help establish who the principle regulators should be. Rather than coming at it from a new piece of cloth, as some have suggested, in a new design, we're working within the existing framework and trying to come up with new term recommendations to help clarify who the principle cop on the beat should be.

There could be a host of qualifying elements that you would look at. For example, what is the principle risk center or what is the principle profit center for the enterprise, and do they hold themselves out to be principally engaged in futures of business or not. But we could sit down with staff and talk through qualifying elements and with hope, and here's what we're after, is to have one principle regulatory relationship. Unless, and until there is a substantial judgment by the associated jurisdiction that the person presents risk to the securities side if it were a CTA/CPO shop.

In that case, dual registration would certainly be understood and we would be hopeful that the dual registration regime would be facilitated by the sharing of appropriate data between both agencies, but simply filing once.

Still, we're hunting for a simple one-stop shop with which to provide the required information. We have no objection to providing the information, but we would like to have one set of questions with which we know we wouldn't be caught between the two countervailing perspectives of the agencies.

CHAIRMAN GENSLER: Maybe with my time you could focus on my second question, if possible. But either one.

MS. MORIARTY: Before we do that, may I just say that I agree with your, you know, principles, of how to divide up the two. I'll also make the observation that if the 8,000 hedge fund advisors are registered with the Division of Investment Management, the SEC is going to need an enormous infusion of capital and staff to deal with that. It's double, I think, what you would need currently. And that'll be a huge challenge.

But I agree that it should be a principle engagement as a method of discerning who should be regulating which aspect.

As to the position limits, I think it is a difficult question, but I take the point that John Highland made in his testimony before you back in August, that he believes that the bona fide exemption, hedging exemption, should be applied to passive funds that are not, have no intention of moving the market but are simply holding and trying to track the price performance. I think that would make sense.

I will say, however, that the prospectus for that fund and for many other of the commodity funds, do make it clear that the imposition of position limits is a possibility. And investors should be aware that that could happen. The underlying assets are different than securities and it may be the case that, under certain circumstances, limits ought to be imposed.

I think what you might have happen, if you permanently impose a certain level, is that you'll have a bunch of funds. Instead of having one fund that will hold, you know, X, you'll have ten funds that hold 1/10 of X, or 20 times. I think that may be the way the industry would deal with it.

CHAIRMAN GENSLER: I think my red light's on and I'll try to police myself, at least, maybe not the others. But unless there is something different that's going to be said, I'm just going to pass on to, I think, Commission Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. You preempted me on the first question on registration.

CHAIRMAN GENSLER: You shopped at Tiffany's, too, you say?

COMMISSIONER DUNN: No, I was wondering if you were hinting he should leave party favors here.

Let me ask kind of a general question, and whoever on the panel wants to address it and let me take time to recognize my former colleague and mentor at the CFTC, Sharon Brown-Hruska. Sharon, when I say you're my mentor, you get blamed for everything I do wrong, so, be careful with that, I guess.

Michael Connolly, you somewhat addressed this, but I'd like to know, from any of the panelists here, what constitutes a standard and a non-standard over-the-counter derivative? Which has the greatest potential for having systemic risk and should they all be cleared?

MR. CONNOLLY: If I may, from a corporate's point of view, especially a publicly traded corporate, you know, we've got two issues. One is to make a good economic decision and the other is to not create any noise in our financial statements. So we always have to work with hedge accounting.

The hedge accounting requires that the hedge that we enter into has very specific components to it: a termination date, an underlying transaction. I'm buying this many ounces of silver on this particular date. So from our perspective, you know, it is a true transaction with a real underlying obligation on my part. If I make the wrong economic bet, that's different. You know, if I think silver's going to go one way and it goes the other, well then, my CFO's got a problem with me.

But the whole goal is really to have something that is tied into, you know, an underlying transaction that's predictable.

MS. BROWN-HRUSKA: And I would just add that those are highly customized and quite diverse in terms of demands for hedging, in terms of the amount, the re-set dates and termination, and cash flow considerations. And so there's a great deal of customization out there and it's, you know, again, it's going to be very difficult, I think, to force all of the derivatives OTC market through central exchanges, or even through clearing processes.

But I would agree with a lot of the good work and the thinking that's going on. Certainly we've seen that CDS contracts are very amenable, highly amenable to standardization. And I've worked with a lot of the dealers and the processes that they use to handle the major defaults and it's working very well. They're very impressive and I think that there's been a lot of progress made there.

MR. BAKER: If I can jump in quickly. Three baskets. First, the plain vanilla can ultimately move to exchange a lot of structural work to get there in the meantime. Central clearing, that the non-standard are very unique, particular to a particular individual firm or desire to modify. And it's not difficult to exchange or central clear. It's impossible. You will take that risk management tool away from individual needs that it serves a valid public purpose. But we have no objection and support the idea of reporting to a trade repository so that the regulatory team can look at what's going on in the market while not impairing reasonable business function.

COMMISSIONER DUNN: And no one wanted to take a crack at which might create the greatest systemic risk?

MR. BAKER: I'll give you just a cryptic one that I keep for my Congressional pocket from long years ago. There's a factor called Herrstock Factor, where there was a bank in Germany that was in foreign exchange trading that went kaput in between receipt of New York banks' U.S. dollars, or Euros, at that time, francs, they were trying to convert back to U.S. dollars. They went kaput in the middle of it, and nobody ever thought that guy in Germany could create the havoc he did by going upside down. You never know.

In Congress, we couldn't define systemic risk, we didn't know what to do about it when we saw it, and we couldn't decide who should have the job. I think we're pretty much in the same place.

MS. BROWN-HRUSKA: I would just add, too, that, you know, we've looked at margin and collateral requirements. I mean, it's certainly the case that OTC derivatives dealers have significant regimes for risk mitigation in terms of collecting collateral and setting the level of collateral based on not just the position itself, like exchanges do, which is simplistic compared to the OTC markets' risk management capabilities.

Now, what we know, they weren't keeping enough collateral in recent years, but they certainly have the capability to, in a more sophisticated manner, manage counter-party credit risks and systemic risk, than the current exchange model that we see. And that's just my view.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn, Commissioner Casey.

COMMISSIONER CASEY: Thank you, Mr. Chairman. I'm also very cognizant of the time. So I have a very, it's a short question and for any of you who want to have a more fulsome response, maybe you can provide that for the record, as well. Just, in the interest of allowing all the Commissioners get their questions asked.

Mr. Baker, you note in your written testimony, obviously supporting the distinction between investor protections for retail and sophisticated customers and I think consistent with calls that we heard yesterday and, I think, more generally over the years, about the confusion and redundancy that comes with the various different standards, definitions, for sophistication.

And so, I think the notion of harmonizing and simplifying those various standards is obviously something that we need to undertake.

I actually have a question about, you know, how we look at the question of sophistication. Whether or not there are any additional insights that you could provide to us with respect to how we currently set the thresholds for sophistication. Not just in terms of investing in investment funds, but also just some of the experiences we have taken from the crisis. And I think Chairman Gensler mentioned it yesterday with, you know, sophisticated investors admittedly not appreciating fully the risks of certain complex products that they were investing in.

So if you could talk a little bit about that.

MR. BAKER: Yes, it's very difficult to subject an investor to a quiz and have him hit a certain score and then they can invest. And unfortunate as it may be, wealth has been equated with sophistication and therefore, if a person inherited substantial wealth from the parent who was sophisticated, they're still legally entitled to invest in investment they otherwise might not be competent to take on that risk. It's a very problematic area. We recognize and have supported increasing those dollar requirements on, again, the historic assumption that when those dollar values were set, in today's world, that is a very deflated standard of conduct.

Now, with the market performance of '08, it might not be so bad. We'd have to kind of look at it in relative terms, but it may be that that figure needs to be annually adjusted, or constantly reviewed. We certainly understand the need for it and would be very supportive. By count, I think there are seven different sets of terminology that define who is eligible to participate in certain risk taking activities. We ought to get back to maybe one or two, if we could, and have it consistent with all regulated parties. Thank you.

COMMISSIONER CASEY: Another alternative might be to consider a sophisticated party anyone willing to lose all of their money without government intervention.

MR. BUTOWSKY: I would just add that I agree with all that's been said, but I would just add to it that, on the broker-dealer side currently, we certainly impose on broker-dealers an obligation to know that a security is not only suitable for someone but also is suitable specifically for the person to whom it's sold. And there have been releases from FINRA that have indicated clearly that the level of dollars isn't only the determinate factor.

So I would say that one place maybe to start is to look there and see what's already being done. Because when people get examined on the broker-dealer side, they're certainly held to the standard of having determined suitability. So I would just say that when a product goes through a broker, arguably that's already being done.

MR. BAKER: I have a simple version. It's the Louisiana Pasture Test. You can go out and eat all the grass you want, wherever you want to go, but when you get sick, you can't come back here for the veterinary treatment. So.

CHAIRMAN GENSLER: Thank you for that farm analogy. And thank you, Commissioner Casey. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman. I'm also going to be very brief. I just have a quick question with regard to OTC derivatives, that if any of you have a comment on with regard to us looking at global standards and what you feel may be the most important issue that we should be considering as we are looking at global standards for OTC derivatives.

MR. CONNOLLY: Well, as a multi-national, I'm hedging in two different directions here. I may have my Japanese company that has to hedge a U.S. dollar liability, so I think a standardization certainly makes things much clearly from my side, speaking from the point of view of a corporate treasurer. Any corporate would look for some level of standardization.

I mean, okay, we're working within GAAP and if you ask me now if that moves over to IFRS, you know, obviously we're talking about different groups here, but those types of standards would certainly make my life easier so that way, depending on the direction of a specific transaction, I don't have to look at new rules every time.

MS. BROWN-HRUSKA: I just wanted to ask you, did you mean with standardization within the ISDA master agreement or in the ISDA guidelines? Or do you mean something more profound than that?

MR. CONNOLLY: Well, definitely within the ISDA. Certainly, from that point of view and also just from the underlying transaction. You know, whatever the currency pair is, or whatever the interest rate movement is.

MR. BAKER: And I would just report that our counterpart in London, EAMA, and our association, are working closely together. It's being fueled rather fervently by the EU directive now pending. And the implications the directive will have, by way of notice, it's very adverse to you as managers interest, and so we have an extraordinary focus on that at the moment. And I can provide you more information on the derivatives fund. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers, Commissioner Walter.

COMMISSIONER WALTER: I, too, will be quite brief. I just got a couple of very targeted questions. First, for Sharon, from what I'm hearing, you would oppose requiring standardization but support facilitation of standardization. And I wanted to make sure that that was correct and also to ask you if it was your view that market forces would then lead to standardization where it's appropriate.

MS. BROWN-HRUSKA: That's a good question. Because you think about the exchanges, who, you know I've worked with for years, and who have tried to introduce standardized products in a, you know, like swaps on exchange traded swaps, and have had very little interest. I think the experience of the credit crisis, the failure of Lehman Brothers and concerns about counter-party credit risks, actually has created a demand for more standardized products. Some of your members have expressed to me interest in trading more standardized products.

So I guess the short answer is, yes, I think market, there's the market forces now that maybe we didn't have before with this heightened concern about risk and about a desire to have efficient processing that exchanges offer. So yes.

COMMISSIONER WALTER: Thank you. And Kathleen, I haven't had the benefit yet of reading your written testimony. I just assume, I'm very intrigued by your idea of investment company act regulation in the absence of legislation. Do I assume correctly it's spelled out there and we can reach out to you if we've got questions?

MS. MORIARTY: No, it's not spelled out and it specifically says it isn't spelled out because I really began to focus on it yesterday during the panels. So I would need to flesh it out. It's a thought that occurred to me in the spirit of trying to think of new ways to solve old problems.

COMMISSIONER WALTER: Well, I, for one, would very much appreciate that even if it was just a bare-bones outline. If you could do that and submit it to us. And the final thing I wanted to cover, was to echo Commissioner Casey's issues with respect to how to define sophistication. And just to throw the thought into the hopper, picking up on the notion that perhaps we need one or two standards that, I think, sometimes I think gross proxies work.

It depends on the purpose for which they're working. And sometimes they're really less satisfactory. But I do really think that it's an area where we will never get it perfectly but I think we should try to make some more progress because I, for one, am very concerned about institutions that, undoubtedly are institutions, but they, so many of them act as a proxy for the same small people that we wouldn't permit to lose their money in an unshielded fashion. And we have to decide when we need added protections. That's all I have.

CHAIRMAN GENSLER: Thank you, Commissioner Walter. I note the record, I think, is being held open until September 14th, so it would be wonderful if anything, that you have further submission, make that available. And then it's Commissioner Chilton.

COMMISSIONER CHILTON: Thanks, Mr. Chairman.

Commissioner Brown-Hruska, I wonder if you can give us the benefit of your thoughts about how we actually move forward on a lot of these issues, regardless of what the actual "fix" is that, you know, these were here when you were at the Commission and they continue to be and Mr. Downey earlier spoke about sort of deep-lying interests among staff, etc., and I'm just curious. Do you see a way out of this? You know, this is, I talked about yesterday. You know, I think it's a great start, and as I said, you know, both our Chairs are driving leadership in this area, but I wonder if you have any suggestions for your experience on how we go forward?

MS. BROWN-HRUSKA: Well, thank you, Commissioner Chilton. You know, I have paid attention quite a bit to, you know, developments and ideas that have been circulated as ways to solve problems like high energy prices, for example and the crude oil spike. And I think, you know, some, even though I know you're still continuing to actively investigate and I know how good that enforcement division is. And if they see smoke, and they'll dig until they find the fire. So I know how good they are and I know that you do have a significant authority to police the commodities markets and do so vigorously.

And you know, some of the things that have been circulated like, you know, ramping up position limit levels, or down rather, ramping them down, so that they act as constraints upon legitimate market activity, hedging activity, and even in some cases, legitimate speculative activity based on information that is acquired appropriately by, you know, financial entities and other traders.

You know, you've got to be really careful, I think, not to over-reach. Having said that, I think this, you know, I've talked to Commissioner about this. I do think that it's appropriate for the CFTC to have authority to set position limits in all commodities. I don't see the need in financial commodities, but because I know these are issues that you have focused on, I just wanted to throw some of those --

COMMISSIONER CHILTON: Thank you. I'm interested in more of the, and I appreciate that very much. But I'm interested in the areas of mutual interest on these sort of embedded issues that, how do we as a Commission, go forward? It doesn't seem to have worked too well in the past. So maybe you don't have an answer.

MS. BROWN-HRUSKA: Well, I do have lots of answers, but we don't have time. I would just say, keep going the way you're doing. It's wonderful. I'm absolutely thrilled to see the accomplishments that I think are ahead. I really believe that these commissions can pull it off. I asked Bill Donaldson for, you know, the ability to exempt our registrants from registration with the investment advisors act because I felt that they were well examined by the National Futures Association. And I got my answer and you know what it was. And so you know, I think this process that you're going through now, where you're actually making progress in coming to, it's fantastic.

COMMISSIONER CHILTON: I agree. Ms. Moriarty, you talked just a little bit about harmonization of regs and I’m particularly interested in that, with regard to ETFs. Can you sort of expand on how you think we might go about that?

MS. MORIARTY: Well, in order to do it, I might have to take you aside because a lot of it is incredibly boring and, you know --

COMMISSIONER CHILTON: Well, we don't want to do that. Why don't you submit the boring stuff for the record. I did have one quick question, though for others, if anybody has, jumps out at this. One of the things we haven't talked about a whole lot is foreign security indexes. We have a mandate which, by Congress, to come to some agreement, these two commissions, which was due June 30th. So we're sort of behind the 8-ball on that one.

How significant is this for you all? Does anybody think this is a, we're going to do it because Congress told us to do it, but I'm curious if this is a big issue for any of you all? I guess not. Yes, sir?

MR. BUTOWSKY: Can I take a crack at answering your prior question, though, about working together?

COMMISSIONER CHILTON: Yes, yes.

MR. BUTOWSKY: Just one thing with that. And I take your point about not getting into the minutiae, but I think a lot of, I work with hedge funds and private equity funds every day in my practice and I would look more to, rather than the over arching issues, more to the minutiae that exists out there that I think causes problems.

A couple things that I could see that might be helpful. Kathleen, one of the things that you and I talked about was possibility for joint exams. I think, between the regulators, I think that's a good idea. I think one of the things that's downplayed, but that one of the things that would be very helpful, if you make the assumption that 90 to 99 percent of the people out there in the industry are all good, well-meaning people, is having very, very clear statements of expectation as to what's expected of them.

You've got a problem when you have principal based and fiduciary statutes and frankly, many times, people learn what the law is through hearing what somebody got in trouble and in enforcement action on, where prior to that, nobody ever would have thought something was an issue.

COMMISSIONER CHILTON: Very good point. Thank you.

MR. BUTOWSKY: And I think there are many, many interpretive releases that could come out of the regulator that would go a long way towards eliminating a lot of bad conduct. One that I would just mention that I think is one of the best releases the SEC ever did, was the 28(e) releases from a couple of years ago. Probably from a self-interest point of view, it wasn't in my self-interest, because it answered most of the clients' questions, but it was replete with so many examples from an interpretive point of view, basically put to bed a lot of issues. And put people on notice of what they need to be dealing with.

The other thing I was just going to get to, and I know this is probably a much bigger item, if this would ever be doable, but if, we're going to have one principle regulator, you could easily have a form, at least, that's a co-registering form, that works for both. So that at least the syntax, the verbiage, is the same. And the last one, I promise, is just when we come to the regulations, there are examples of regulations that went down the path that are similar. There's a dual employee rule in the commodities laws, there's one under the Advisers, under the Investment Company Act.

Even if you have rules that are fairly similar, after that happens, you can have a divergence by no action letters, by interpretations for the various staff. So there has to be an effort not only to have similar regulation, but also to make sure that interpretations are the same afterwards. Thank you.

CHAIRMAN GENSLER: Thank you. Commissioner Chilton.

I'm also going to thank Mr. Butowsky, because you did commit to put this on the record, so we'll, if you have it in writing, and then we can --

MR. BUTOWSKY: That doesn't constitute it, okay.

CHAIRMAN GENSLER: I think it's, Commissioner Aguilar.

COMMISSIONER AGUILAR: Thank you, Chairman Gensler. And I realize we're past our allotted time, so I'm going to see if I can break the record for Commissioner briefness in asking and answering his own question. But let me -- I know we've received a lot of materials, some late last night, some as recent as 7:00 this morning.

I actually had a chance to read Ms. Moriarty's, and although I've not read all of them, I think you may have been the only one who actually used the word education in your testimony. And it caught my eye, because I do think, as we're trying to harmonize, one of the things we can do for investor protections is harmonize the education we give them because they're looking at all products that are, whether or not we find a primary regulator, both agencies are involved, and it would be good if we could do cohesive, comprehensive discussions in a plain English level that investors could sort of understand the different products and the different rights associated with them vis a vis standards of care, even if we continue to be having different standards. I commend you for that.

I really -- my questions are to ask for perhaps two responses for the records and one would be for Ms. Moriarty. When you respond to Commissioner Walter's request, I noted in your suggestion, it was really one of voluntary inclusion under Section 6E and so I'd like for you to address how people will be tempted to actually take advantage of coming to us, registering, even if we provide a Section 6E series of exemptions to make it workable for them. People don't always voluntarily come to a regulated world, and I would love your thoughts on that.

And lastly, because I don't think it was in your testimony, Mr. Baker, it may have been, I may have missed it. The issue of primary regulator and how you determine if primary regulators come up. And you mentioned that, I'm not sure if you're going to have near-term recommendations or whether they've already existed but if near-term could be before the 14th of September when our records close, I would love to have a fairly well fleshed-out, the beginning of thought pieces of the factors one would look at. And if you care to respond, I will move on and give it to Commissioner Paredes so we can go have lunch.

CHAIRMAN GENSLER: I also follow Commissioner Aguilar's judgment of moving on to Commissioner Paredes.

COMMISSIONER PAREDES: Thanks a lot. I think I'll just limit myself to one question here. We're going back to, I think something that Dr. Brown-Hruska mentioned in passing, in your remarks, which was so-called naked CDS. And what the issues are there. Certainly it's something that's received a lot of attention, but since you mentioned it, it's worth getting your thoughts if any others have something to chime in on, that would be great.

MS. BROWN-HRUSKA: You know, I find it very hard to comprehend the, I don't know, sort of the panic-stricken reaction to the CDS market in general that has led to some of these, I think, really detrimental proposals for their trading for how they're used. You know, with the exception of the CDS market on mortgage-backed securities, which we all know went south, and really was held in broad proportion by AIG, and you know, the CDS market at large, has performed exceedingly well. Even when the bond market, the underlying debt securities were struggling throughout the last two years, the liquidity has been better and more price-efficient than sometimes the cash market.

So you know, to sort of turn around and want to punish a market, basically kill it, is what is short of a naked CDS ban on would result in. It certainly would shoot up the cost immensely. It is, you know, I'll submit some more thoughtful, you know, sort of economic arguments of why I think it's a bad idea to you. But it's just, you know, again, I just think it's extremely premature and really shows a lack of understanding of how the markets work.

MR. BAKER: If I may jump in just to give a quick explanation. A pension has a technology portfolio. Six stocks. It wants to minimize volatility in revenue to pay out pensioners checks. It goes to a bank and buys a technology credit index. The index may have 40 stocks in it, but it provides stability in the revenue strength. When that transaction occurs, since the pension doesn't have an underlying financial interest in the other 44 stocks that is in that index, that could be determined by the regulator to be a naked Credit Default Swap transaction.

In essence, that exchange, provides security for the pensioner by enabling the pension to better meet its long-term revenue obligations. And so we need to be real careful about automatically saying, this product is inherently bad. It may be used inappropriately at times, but on balance, it is a very good product that needs to be preserved for economic functions.

CHAIRMAN GENSLER: Thank you, Commissioner Paredes.

Chairman Schapiro.

CHAIRMAN SCHAPIRO: Thank you. And I'm very conscious of the fact that, yet again, we've kept people over the time. And thank you very much for your generosity in being here with us.

I guess I would ask, maybe, for the record, to get some information in a particular area. We have multiple categories of dual registrants. Broker dealers and FCMs, investment advisors and CPO CTAs. One of the things that would be helpful to us, and maybe, Kathleen, you and Michael might be particularly well-suited to do this, would be to help us focus on those areas of the regulatory regime for advisors and CTAs. They're in conflict, as opposed to overlapping, and duplicative, and burdensome. So we can sort of early-on focus some of our attention on the areas that are creating real conflict for registrants.

And I would very much appreciate getting that kind of information. Again, on behalf of everybody, both Commissions, both Chairs, thank you all so much for all you've done to help us be enlightened about some of these issues today. Thank you. I guess we're adjourned.

(Whereupon, at 2:38 p.m., the meeting was concluded.)

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PROOFREADER'S CERTIFICATE

In the Matter of: JOINT MEETING ON HARMONIZATION OF REGULATION

File Number: 4-588

Date: Thursday, September 3, 2009

Location: Washington, D.C.

This is to certify that I, Donna S. Raya, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

______________________________ ______________________________

(Proofreader's Name) (Date)

REPORTER'S CERTIFICATE

I, Jon Hundley, reporter, hereby certify that the foregoing transcript of 142 pages is a complete, true and accurate transcript of the testimony indicated, held on September 3, 2009, at Washington, D.C. in the matter of: Joint Meeting on Harmonization of Regulation.

I further certify that this proceeding was recorded by me, and that the foregoing transcript has been prepared under my direction.

Date: ____________________________

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