

COMMODITY FUTURES TRADING COMMISSION

GLOBAL MARKETS ADVISORY COMMITTEE

MEETING

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First Floor Hearing Room
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

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P R O C E E D I N G S

CALL TO ORDER AND INTRODUCTIONS

COMMISSIONER LUKKEN: If everybody wouldn't mind taking their seats, we'll get started. I wanted to welcome everyone to this meeting of the Global Markets Advisory Committee, or GMAC, as it's called. I'm Commissioner Walt Lukken. I'm Chairman of the GMAC.

The Commission formed this Committee for the express purpose of seeking industry input on matters that impact the global derivatives marketplace. Our agenda today certainly delivers on that front and I look forward to a lively discussion on those matters.

Before we get started, I would note that since our last advisory meeting, the face of the Commission has changed. I wanted to publicly welcome Commissioners Fred Hatfield to my left and Mike Dunn to my right to the Commission, and also recognize Sharon Brown-Hruska who is our new, or relatively new, Acting Chair since our last meeting. In a moment, I'll turn it over to them to give some

opening comments, but I want to take this opportunity to acknowledge the new look of the Commission.

So that no one talks disparagingly about them, I'd also note that a couple of our Committee members are participating by phone. I believe we have Emily Zeigler, George Crapple, and Bo Collins on the line, and we welcome them, as well.

First on the agenda, I'm delighted to have before us Assistant Secretary for International Affairs of the U.S. Treasury Department Randy Quarles. Secretary Quarles will outline for us the state of U.S. negotiations with China regarding progress towards a more flexible currency regime and why such a change is important for the U.S., China, and world economies.

I'm also thrilled to introduce Ambassador Paul Speltz, who serves as Secretary Snow's front-line emissary in China on these negotiations.

Both of these honored guests have been strong advocates for our business in China and how the derivatives markets, both on exchange and over-

the-counter, can facilitate China's transition to a more flexible currency regime. I look forward to their presentation and hearing from our members on these issues.

We will also hear from the Chicago Mercantile Exchange regarding their technical assistance agreement with the Chinese government on the development of the Chinese derivatives market. I believe that private sector cooperation and technical assistance will be the cornerstone of a successful Chinese derivatives market and we look forward to this discussion with CME and other market participants who are engaged on these issues.

Our second agenda item is a progress report from our Subcommittee on Bankruptcy, which was formed at our last meeting in June to analyze the handling of customer funds. The current segregated funds and secured account regime has been in place for nearly 20 years without significant reform or modification. It's appropriate to review the adequacy of this system

in light of the global and interconnective nature of our markets.

This group has the difficult task of determining the most effective means for protecting the financial integrity of our markets, firms, and its customers, whether it is the current system or a modification of that regime. I am pleased to note that the Subcommittee has made sizeable progress on these policy questions and I look forward to hearing their update.

Lastly, our agenda includes an update from staff of the Congress regarding CFTC reauthorization. The authorization of the CFTC expires in September and will require a statutory renewal. Because the procedures of the House and Senate are often thought to be as arcane as derivatives trading, I have asked two veterans of Capitol Hill, Andy Morton from the Senate Agriculture Committee and Dave Ebersole from the House Agriculture Committee, to help us make sense of the process and to brief us on what we might expect in the coming year. Because of the global

focus of this Committee, I would ask that any comments or questions in this area focus on the international side of the business.

With that outline before us, I would ask our distinguished Acting Chair and other Commissioners whether they have an opening comment for the good of the order. Chairman?

CHAIRMAN BROWN-HRUSKA: Thank you very much. It's a pleasure to be here today to take part in this meeting of the Global Markets Advisory Committee and I just want to thank and commend Walt Lukken for his work organizing this exciting agenda for today's meeting. The topics, I believe, touch on some important areas of the global derivatives industry, the importance of risk management to international business and the economy, financial and economic integrity, and the role of regulation in the global marketplace.

There is no doubt that the derivatives markets and markets in general are becoming more global in nature. I've looked it up and found that the value of world commercial services is \$1.8

trillion and financial services represent a significant component of that sector.

With that backdrop, we know that China's progress towards a more flexible currency regime is certainly among today's top issues in world trade and in world business. In 2003, China's trade with the world was valued at just over \$851 billion. Now, typically world trade is conducted amongst industries and business in a floating currency regime, though not in the case of China, as you know, which has pegged its currency to the U.S. dollar.

As a professor of international finance before I became a Commissioner, I can tell you that pegged currencies, when they're pegged across disparate economies, can create significant structural problems, including unsustainable balances and painful welfare consequences, primarily in the market of the undervalued currency. Our focus is mainly on the impact in the international trade perspective, but I think China is wise to

consider moving in the direction of a more flexible regime. I would commend them for doing so, because economic history suggests that they have a lot to gain by moving in this direction, and I would again commend Walt and the folks at Treasury who are here today, Randy and Paul--thank you very much for joining us--and others who are working towards a more sensible currency regime in China.

As they move in that direction, I know that they have to strive to provide businesses and individuals with tools to deal with currency risks, and hence futures, options, and derivatives. These are the tools that really fit the bill and we're happy to provide any expertise that we have at the CFTC and that of our advisory committees, as well, to help China in any way we can as these markets develop.

As Chairman of the GMAC, once again, Walt has done a tremendous job furthering this effort, working closely with Treasury and Chinese officials to help provide logistical support, guidance, and I really look forward to the update and the

discussion we'll hear today on progress in that area.

With respect to bankruptcy issues, I believe that it is also very important for us to understand the consequences of bankruptcy in an international setting. It's going to be an important issue in every aspect, I think. Whenever we're considering new approaches, innovations in our markets, we're seeing that bankruptcy is an important issue for us to get our arms around, especially if you want to see continued growth in this sector, as we have. It's also timely in the sense that we're seeing an ongoing development of international clearing arrangements and a rising desire of customers and firms to conduct business in foreign financial centers.

And finally, we come to the issue of reauthorization and I think the reauthorization of 2000 was historic in that it really opened up the markets for international derivatives and the core principles model of regulation that was enacted in the Commodity Futures Modernization Act,

really provided a blueprint for regulation that enables innovation and change in the global marketplace.

Over the last decade, many changes have come to the derivatives industry in an international context and perhaps the greatest being the shift to computerized trading, which has raised global access and opportunities for the truly global financial services industry.

So with the reauthorization process set to begin, I think it's really timely that we ask this question. Is the CEA flexible enough to deal with today's global marketplace and changing needs of business and investors? I look out at this outstanding group of leaders in the derivatives industry and otherwise that comprise the GMAC and I certainly know that I can depend on you to focus on this issue going forward.

Andy Morton, Dave Ebersole, thank you very much for joining us and providing your expertise and your insight in the legislative sphere and I

really look forward to all of your remarks today. I again thank you very much for coming and participating.

COMMISSIONER LUKKEN: Mike, do you have any comments for the group?

COMMISSIONER DUNN: Thank you very much, Walt. I'll be very, very brief. I must say that I am very pleased to be here today, and I feel especially fortunate to be able to attend this type of forum so early in my tenure here on the Commission. The increasing globalization of our markets and their participants will continue to raise interesting and significant issues for the Commission, and I very much look forward to the discussion and deliberation that will take place here today.

Advisory Committee meetings with the Commission are an extremely important aspect of getting information to the Commissioners. The input that you give is going to certainly have an impact on all of us. I've been told that these debates can get very lively at times, and I

certainly look forward to taking part in that and, for the most part, observing.

I'd like to especially thank Commissioner Lukken for putting together an excellent agenda. I would also like to thank our guests from Treasury and from the Hill that are here today to help inform us, and thank each and every one of you for taking the time to work with the Commission. I look forward to this discussion.

COMMISSIONER LUKKEN: Thank you, Mike.
Fred?

COMMISSIONER HATFIELD: I'd also like to commend Commissioner Lukken and the Committee for the important work that they've done and are doing. I'm very happy to be here, to have joined the Commission. A month ago, Mike and I joined. I have known some of you for a very long time and some of you I've known about 30 minutes.

[Laughter.]

COMMISSIONER HATFIELD: I look forward to meeting the rest of you, hopefully a little later this afternoon. But I also want to again commend

the Committee for the work that it's doing and to welcome our guests and turn it back to you, Commissioner Lukken.

COMMISSIONER LUKKEN: Thank you. Just as a matter of technical assistance, please, as you speak, turn on the mike, and when you stop speaking, turn it off so that others might be able to speak. We're updating our mikes soon, so we'll be rid of these things shortly. But I just want to remind folks of that.

With no further adieu, I'll turn it over to Assistant Secretary Quarles to update us. Thank you so much.

BRIEFING BY U.S. TREASURY DEPARTMENT OFFICIALS
ON NEGOTIATIONS WITH CHINA
REGARDING ITS CURRENCY REGIME

MR. QUARLES: Thanks, Walt, and thanks to the Commission. I really appreciate the opportunity to be here today to discuss the China issue from the Treasury perspective and particularly the role that the financial sector plays in the matters that we've been discussing

with China.

And just to begin from first principles, very briefly, the underlying principle for the administration's international economic policy has been to try to increase growth around the world. Rapid economic growth at full potential is the most effective way of creating jobs, of raising income, the best way of pulling countries out of poverty. So if there is one principle that everything would fall under, it would be that of increasing economic growth, and so in that regard, the very rapid growth of the Chinese economy and its increasing integration into the international financial system and the world trading system is a continuing success and an opportunity for everyone.

Chinese growth has been a major source of support for world economic growth in the last few years. I think in 2003, China and the United States together accounted for half of the world's growth.

Now, sustaining China's growth in the future is going to depend on a number of things,

but among the most important is the creation of a modern and efficient Chinese financial system. The empirical evidence that links an efficient financial sector with economic growth is quite strong. A number of studies indicate this, I perhaps most notably a fairly rigorously done World Bank study from not too long ago.

But in China, that link is likely to be especially true in the future as the sources of growth in China shift away from dependence on increased capital and labor inputs towards reliance on productivity increases and increases in total factor productivity. An efficient financial system is an integral part of ensuring that resources flow to the sectors where they can be used most productively and profitably, and in China's transition from a command economy, where the risks were all socialized, to a more market and private sector oriented one, creating instruments for businesses to manage risk is going to be crucial.

Foreign expertise can and should play a crucial role in the development of China's

financial sector. Foreign firms can assist China in developing its capital markets, its financial institutions, its financial instruments and trading systems that are needed to modernize its economy and to support its currency reform. Foreign firms are important sources of new capital. They're important sources of management expertise. They're important sources of risk management systems and technology.

So an integral aspect, in our view, of China's financial sector development is going to be to open the sector up to foreign competition, both by allowing majority-owned affiliates and by expanding the scope of products that firms can offer. For example, foreign firms can't establish wholly-owned securities operations in China. They're still limited to a 33 percent stake in a Chinese firm. Asset management firms are capped at 49 percent. And moreover, current regulations forbid securities dealers from dealing in derivatives products.

So expanding foreign firms' access to

China's securities markets and banking sector should encourage competition, should introduce better products in financial services, including foreign exchange. We're encouraging China to open these sectors.

Some of the recent steps that are important in this financial sector and capital market reform, China's been allowing foreign non-bank auto finance companies to extend auto loans. They've approved over 60 foreign banks and financial institutions to provide REMNIMBI products and services to Chinese companies. They're permitting about 25 foreign institutions to invest in Chinese capital markets. I think everyone here is familiar with the fact that Goldman Sachs recently was permitted to acquire a controlling stake in a domestic Chinese securities firm. That may be a one-off transaction, but it does demonstrate foreign involvement in China's securities business. UBS has acquired a 49 percent stake in a Chinese fund management company. That was the first in China. Others are expected to follow.

Foreign regulators play an important role in this process in sharing their expertise and developing regulations and supervisory skills for the Chinese, and certainly the Treasury has been very appreciative of the technical assistance and training that the CFTC has given to China, in part because--in no small part because of the important role that the increased availability of derivatives products will play in China's currency reform.

A well-supervised and well-capitalized, well-managed domestic banking system is also important to ensure that removing controls on capital flows and interest rates is done in a manner that safeguards financial stability, and all of this, as well, is integral to the Chinese understanding of their currency reform.

So some steps, some recent steps, at least, that the Chinese have made to their banking sector reform, they've restructured state-owned commercial banks to attract strategic investors to prepare for public listing. There's a focus on capital adequacy addressing non-performing loans.

Simplifying the procedures for disposal of the large number of non-performing assets. Reforming the ceiling on bank lending rates, again, moving to a more market-oriented system for determining the pricing of credit. And foreign banks continue to invest in Chinese banks.

Now, with that background, let me say a few words about the Chinese currency reform. The Chinese authorities have clearly stated their goal of moving towards a market-based and flexible exchange rate regime. It's for a variety of reasons, as Sharon mentioned at the outset. It's in the Chinese interest. A more flexible exchange rate regime gives China much better control over its own monetary policy, strengthens its tools for macroeconomic management to ensure sustained economic growth, which again is the overarching principle that at the Treasury we're trying to promote.

The Chinese officials have stressed that an important element of their efforts to move to a more flexible regime is the development of the

infrastructure of foreign exchange trading, including the development of FOREX options, futures markets that allow firms to manage foreign exchange risks. And connected with that is the development of internal controls on foreign exchange exposure and the supervision of foreign exchange rates.

But China's taking measures to expand permissible capital transactions in order to increase the liquidity of foreign exchange markets, making them more efficient at transmitting price signals.

Some of the steps that China has recently taken to liberalize the capital account. One, they allowed their national social security fund and domestic insurance companies to invest in overseas financial markets. They are permitting residents to transfer assets abroad and business travelers and students to take more money out of China. They're allowing for qualified--there are certain standards that have to be met, tests that have to be met, but qualified foreign and domestic institutional investors to transfer funds more

easily into and out of China.

Over 25 foreign firms have a qualified foreign investor, institutional investor license that they can invest in Chinese securities, and we understand that the qualified domestic investor program is still under study, but that will allow Chinese companies to invest in foreign markets and they are committed to moving forward with that. Recently, over 20 foreign banks and financial institutions have been granted permission to conduct foreign exchange derivative business in China and there are efforts to work with U.S. exchanges to develop trading systems and financial instruments in China.

So--and all of this, again, is central to what is their stated goal of currency reform, the view that ultimately a more--that a regime that permits a freer flow of capital is necessary for a more flexible currency regime actually to appropriately price the currency and that to allow the freer flow of capital, you have to have a strengthened banking and financial sector to avoid

weakening that sector as capital is allowed to more freely leave the country.

We've been heavily engaged with China on this entire range of issues, including the financial sector development. We've developed and implement, I guess, a three-leg or three-pillar program of financial diplomacy with the Chinese on these issues.

First is our own bilateral engagement, which I think has been very active, as most people around this table will know. We've had talks at senior levels from the Secretary on down with the Chinese and again at very senior levels with the Chinese on a range of economic policy issues with exchange rates at the heart of the discussion.

There were Joint Economic Commission meetings in September in association with the World Bank and IMF meetings that were led by Secretary Snow and Chairman Greenspan. Those meetings included senior financial and securities market regulators. The CFTC was there. They were extremely central participants in these talks for

the reasons that we've outlined today, because of the importance of these issues in the Chinese consideration of their movement toward currency reform. Ambassador Speltz continues his substantive talks on these matters regularly with the Chinese on the ground in the area and he'll make a few remarks about his activities shortly.

On the multilateral front, we've broadened our engagement with the Chinese in a number of fora, most particularly, I think perhaps most importantly, the G-7. For some time now, and most of you, I think, are familiar with the G-7 process, the so-called G-7 deputies, the vice finance ministers of the G-7 countries, they meet very regularly, and for some time now they have invited to at least a portion of their meetings the Chinese vice finance minister.

At the most recent meeting at the ministerial level, the Chinese finance minister and central bank governor were invited and they will be invited again to the ministerial in London. While they don't participate in the entire meetings, this

is an opportunity for the G-7 and the major economic powers of the world to engage with China, again, on this full range of economic issues that are associated with the integration of China into the world financial system.

We've also stressed these issues in our discussions in APEC, the Asian Pacific Economic Cooperation Group, in the G-20, which is the group of developed and major emerging market countries.

And then, as well, at the technical level, where we've had our senior bilateral contacts, we have our multilateral contacts and at the technical level, we recognize the need to assist China to develop its financial infrastructure as part of this entire program and therefore the Treasury, with the assistance of our regulatory colleagues, has been engaging in technical meetings with the Chinese to identify and overcome obstacles to moving forward along this path.

We've been very busy in that respect. We set up a technical cooperation group that has had meetings to assist them in discussions about

supervising banks for an exchange risk, developing FOREX derivatives. Thanks again to the CFTC for participating. Later in the course of last year, we had meetings on focusing on the banking sector and banking supervision, resolution of non-performing assets. In September, the Chinese central bank officials came to Washington to learn more about official foreign exchange management, supervision and regulation of a currency derivatives market, and we really have greatly appreciated the exceptional contributions of Walt and the talented team at the CFTC for its program focused on the factors needed for a successful derivatives market.

So going forward, we're going to be continuing moving in all three of these pillars. We'll continue our high-level substantive discussions with the Chinese financial leadership. We are preparing now our action plan for this technical cooperation group for 2005 that addresses the futures markets and other practical aspects of exchange rate flexibility. We are encouraging the

Chinese to take steps to expand their spot and futures trading, developing of FOREX futures markets, and encouraging more access to foreign firms in these markets, and those are discussions, as well, that are happening in the multilateral arena.

So with those remarks, I'd like to turn now to Ambassador Speltz, who is, as Walt noted at the outset, Secretary Snow's emissary to Beijing, to talk about some of his work.

AMBASSADOR SPELTZ: Thank you. Thank you, Randy. I'd also like to thank the GMAC Committee and also thank you, Walt, and your staff, for putting on a very instructive program for the PBOC SAFE in mid-September. They're still talking about it. Actually, if you're not careful, I think they'll come back here and spend a lot of time here with you guys.

I think Randy has really covered this topic very comprehensively, but I would just like to add a few notes. I welcome the opportunity to talk briefly about my role as the Secretary's

emissary, and most importantly is to stress the important role that the private sector financial firms play in China.

Since being appointed President Snow's [sic] emissary to China in April of last year, I've been engaged with the Chinese senior economic leaders on a range of priority issues of financial and economic importance to the Treasury Secretary and the administration. In addition to my ongoing consultation with central bank and finance ministry officials, I meet with the banking, the CBRC, and securities regulators, the CSRC, as well as officials from the Chinese exchanges, both Shanghai stock and futures exchanges, and other financial organizations. I also work closely with many of you who are in this room in terms of your colleagues. I looked at the list of attendees and I think this is what I call a pretty China-savvy group that's sitting around here.

This important aspect of my work in China is--what I'd really like to spend a lot of time on is comparing notes with and meeting with foreign

and U.S. financial institutions who are operating in China, on the ground in China, and by the way, China, I'm talking across the board, Beijing, Shanghai, Hong Kong, banks, investment firms, manufacturing companies. It helps, I think, both of us, from your side and from our side, in gaining valuable insight into your experiences and challenges and helps form our financial dialogue with the Chinese, and I think it does another thing, too. It shows a very positive collective action when we're talking with the Chinese, that they do see that we're trying to sing from the same song sheet in terms of getting things accomplished.

As Randy noted, while Chinese recognizes its need and is very interested in our discussions to create ways to hedge its foreign exchange risks through financial derivatives products, it is also, and we have to be very honest here, very wary of moving too fast, especially in view of the fraud and manipulative scandals that have plagued China's futures markets in the early 1990s. The Chinese government understands the need to closely

monitor these markets to prevent more of these kinds of abuses and, of course, as is well known by all of you, transparency, accountability, is an integral part of this process and all aspects of it.

I think one of the major things that's going on that we all understand is that as far as the Chinese are concerned as they take a look at this, they're looking at it also from a Chinese historical perspective and fear of the unknown is a major factor for them, and what that leads to is a fear of social instability. So it may seem very strange, but taking a look at financial matters, taking a look at currency matters and all the rest, it goes right back down to the whole point of what's going to happen in the future and what will happen with their social stability.

The caution in terms of what they're doing was only further validated by the recent futures trading scandal involving Chinese Aviation's oil subsidiary in Singapore that, as you all know, led to loss of at least \$550 million.

I wish to also underscore Randy's point that the U.S. securities firms and the U.S. exchanges can and is, from my point of view, making a very positive contribution to developing and improving the performance of China's capital markets, including the futures markets. Randy mentioned the market access issues of foreign security firms, which is the focus of my efforts as well as in meetings with the securities regulators. We also raised this issue during recent meetings in Washington in September.

I am optimistic. One has to be, working in China.

[Laughter.]

AMBASSADOR SPELTZ: I am optimistic that China's leadership understands that what it needs to do is to develop a modern market-based financial system. They've said it, and they've said it many times. They don't want to go backwards. They want to go forward. And they understand the need for sustaining what they're doing.

In my role, I look forward to continuing

our productive relationship with China as it moves to reform its banks, its capital markets, its regulatory systems and currency regime. I also look forward to continuing to work closely with many of you who are here in the room and your colleagues in Hong Kong and in China and have the ability to contribute to this process.

I'd be very happy to hear about some of the business experience you have and just want to check with Randy on one note. This was in the newspaper.

MR. QUARLES: Okay.

AMBASSADOR SPELTZ: Randy and I do check on a few things here.

[Laughter.]

AMBASSADOR SPELTZ: Sensitive subject. One thing I just want to note, Randy mentioned the point about the G-7. I think that some of you have seen it already and I think it is being announced that the Chinese have noted their intention to attend the G-7 in London in line with the methodology that they used here in their attendance

in October in Washington, D.C. To me, that shows a continuing signal of their seriousness to stay engaged on a global basis and I think that's a very good sign. Thank you.

COMMISSIONER LUKKEN: Thank you very much, both of you, for your presentations. I think they've raised a lot of questions among the group, but before we launch into some questions, I'd like to turn it over to CME. You mentioned private sector cooperation and CME has been on the forefront on that issue of trying to help China develop their derivatives markets from a private sector perspective. So I'll let Craig take over from here.

BRIEFING BY CHICAGO MERCANTILE EXCHANGE OFFICIAL
ON NEGOTIATIONS WITH CHINA
REGARDING ITS CURRENCY REGIME

MR. DONOHUE: Walt, thank you, and thank you to your colleagues for inviting us to talk about China and some of the work that we're doing.

Before I begin, I want to make a special thank you to Ambassador Speltz and Secretary

Quarles because, as you'll hear from me in just a moment, I think the work that they're doing is absolutely critical to the long-term success for our industry in China as China does emerge and as it does ultimately over time develop, I think, very significant and robust derivative markets.

Having now spent a fair amount of time in China and trying to understand the landscape there and what's happening, sort of reflecting on your comment about having to be patient, I feel bipolar and schizophrenic whenever we talk about China because, on the one hand, there's no question that it is a huge and emerging marketplace, and there's no question that over time they will successfully develop their derivatives markets.

But one of the things that I've learned in the process is that I think it's sort of Pollyannaish to think that all they need from us is to understand how to successfully develop derivative products, how to establish the critical market infrastructure for derivatives trading, risk management, and market regulation and supervision,

and what I mean by that is that as we've all learned in building these markets successfully in North America and in Europe, recognize that you can only have very strong and successful derivative markets if you have very strong, well structured, well regulated underlying cash markets.

As you begin to understand the true situation within China, whether you're examining the way in which the cash equities market works or the corporate bond market or the sovereign debt market or even foreign exchange trading activity, such as it exists within China, you realize that many of the issues that they are facing are ones that are very threshold kinds of issues and that there's just an enormous amount of progress that needs to happen apart from the derivative market development and product development itself, simply just sort of fundamental building blocks in the underlying cash markets that really need to be developed.

So I have personally a much more enhanced appreciation for that. There's no question that

when you meet with market participants and market practitioners within China, there's a tremendous enthusiasm for the reemergence and development of the derivative markets there. There's even, I think, a great kind of competitive zeal among the different players there. There's a competition that exists, I think, between the Shanghai Stock Exchange and the Shanghai Futures Exchange, to name a couple. Even there's a sense that there's a sort of competitive zeal among the regulators for who will ultimately sort of control the oversight and regulation function for the different kinds of asset classes and products and markets that will evolve.

While all of that is very exciting, when you try to talk to people and understand what the true state of play is and the true, you know, sort of time line for the introduction of various of these products, it's very difficult to gain a real insight, I think, and understanding to what is really likely to happen. Very few people in the so-called private sector will really respond to

those kinds of questions. They'll normally defer to the regulators, whether that's the CSRC or the CBRC or what have you. Even when you address those kinds of questions to them, there's a great uncertainty about exactly when and how these markets are going to start to develop and be introduced again within China.

Therefore, having said all of that, the primary focus and emphasis that we've had is really on education and sharing of know-how and expertise with respect to certainly what CME has done and various other people here in this room have done over the last 30 years to develop these markets successfully and in a fashion that helps avoid some of the historical problems that unfortunately have occurred within China in their bond futures market and other issues such as the one that the Ambassador was talking about.

And so to do that, we've had a sort of quasi partnership that has developed between CME and the CSRC, and also I'll talk in a moment about a couple of the other things that we're doing with

other players within China. But we've established a program where we're bringing government regulatory authorities to Chicago, giving them the opportunity in conjunction with the University of Illinois to understand derivative markets. They have the opportunity to work with people with expertise in different areas of CME, whether that's the Market Regulation and Supervision Group or the Electronic Trading Group and the Globex Control Center or the clearinghouse and come to understand how we do risk management in the clearinghouse.

And we are working with them to also adopt some of the standards which most of the exchanges and the derivatives markets have adopted over the last 15 years, namely our SPAN system, and that's been a very, very good program. We've had two exchanges that have lasted for, if you want to call them exchange programs, for a week or two each in September and November, both of which were well attended.

And then in May, we're going to be doing something again jointly in conjunction with the

CSRC which is a symposium that is really oriented less toward sort of market structure and market regulation and risk management concepts and more intended to help impart to people within China basic understanding of the economic principles that underlie derivative markets and why derivative markets and risk transfer concepts are critical to the development of a true sort of open capital market. And so to do that, we'll be working with the CSRC. We will have a number of important economists who will be part of that process--Myron Scholes, Gary Becker from the University of Chicago, perhaps others, and I think that will be, again, very helpful in this whole process of trying to bring China along toward the kind of market that we have here.

But there's truly much to be done. Just in thinking about the development of stock index futures markets, for example, a lot of the issues that exist in the underlying cash market there in terms of disclosure regime issues, accounting standards issues, the fact that so many of the

companies there are really state-owned enterprises in whole or in part and the dynamic that applies to the way that disclosure is managed in that kind of an environment and a whole host of other issues, not the least of which is the inability to engage in short selling in the cash market, give you a sense of the challenges that I think exist before you can actually successfully establish these stock index futures markets.

Similarly, when you look again at the debt markets and the foreign exchange markets, there's a whole host of things like that that really need to be addressed, so education is absolutely critical and that's a big part of what we're trying to do.

We have--I just thought I would mention two agreements that we've entered into with the Shanghai Futures Exchange and with an organization called CFETS, which is the Chinese Foreign Exchange Trading System, both of which have a strong sort of educational and knowledge-sharing component to it, but also we're hopeful, and I won't comment extensively on that, that we will also be able to

develop a commercial relationship as we continue to work more closely with them.

I think Assistant Secretary Quarles said it quite well. We, all of us in this room, can be very helpful to emerging players in the Chinese market because of the technologies that we've developed, because of the critical mass of activity that we have in our markets. One might think about it as a good way for them to begin to learn the ways in which they can successfully hedge and transfer risk and use markets might be by looking outside of China, at least in the initial instance, to participate in these markets that are well regulated, that do have basic sort of safety and soundness features attendant to them, and maybe that can be a way on which, over time, they can successfully, as they certainly will develop their own critical infrastructure markets.

I'd be happy to answer any questions.
That's essentially what we're doing.

COMMISSIONER LUKKEN: Thank you very much, Craig. That's a great overview.

As Paul mentioned, I think a lot of people around the room are China-savvy and probably have some questions for the three of you on what you're doing. I would note that the Treasury officials, because this is a sensitive subject on a lot of fronts, have the right to not answer certain questions that you may ask.

[Laughter.]

COMMISSIONER LUKKEN: I'll just open it up to the group. I certainly have some questions, but first wanted to allow the market participants to ask questions, if they have some, of the officials.

MR. FALK: I just want to go back one step beyond where Craig was. He was talking about undeveloped cash markets to support a futures market. I'd like to ask the Ambassador if we feel that the Chinese legal system has gotten to the point where a foreign entity can get a fair shake in their courts, because one of the problems that have occurred in the past have been where you thought you might have Chinese government guarantees and all sorts of things like that, and

when things go wrong, all of a sudden, it's not my dog, so to speak. Before you sort of spend a lot of money, I think a lot of us are looking at it and saying, if things go wrong, do I have an equal right to sort of claim against a Chinese entity.

COMMISSIONER LUKKEN: When folks ask questions, if you wouldn't mind identifying yourselves. I meant to go around with introductions early on, but if you wouldn't mind introducing yourself so everybody knows who's speaking.

MR. FALK: Harry Falk, New York Board of Trade.

AMBASSADOR SPELTZ: I think I'd say that's a very fair question, and I think in anything--I'm speaking personally--anything I'm doing in China, I'm looking at it from a 25-year perspective. I think you know very well that if you take a look at what China has done in establishing a legal system over the last 15 to 20 years, it's quite remarkable.

Do they have a way to go? Absolutely.

But they're realizing that unless they set up very transparent and very effective rules which are going to protect the foreign direct investor, the financial institutions, the banks, unless they do that, they're the ones that are going to suffer.

So I tie the legal end of it also into the assisting, as Randy was talking about assisting in the fronts in China, and I think if anything, on the legal side, there's been a great deal of work that's been done over the last 20 years on commercial law and other areas.

You raise a good point. It might be something you want to take a look at in assisting them a bit also on the financial structuring law, especially if you get Craig working in groups and things of that nature. That's a special law unto itself.

MR. LEIGHTON: Walt, perhaps if--I'm Roy Leighton. I'm the Chairman of the FOA. For those who are not familiar with the FOA, it's the European equivalent of the FIA here in the States, but I'm also a practitioner.

I've been going to China since 1973, so I've been doing business there for a long, long time and seen lots of changes, and I thought it might be helpful if we just told you what we're doing in the U.K. in particular at the present moment, because the FOA, following the visit of the Chinese Premier, Wen Jiabao, to our Prime Minister in the summer of last year, the U.K. offered bilateral help in a number of areas, but particularly one of them was the development of financial services, and the Chinese asked for help in the development of a corporate bond market with associated financial derivatives. So we're talking about interest rate derivatives rather than foreign exchange, although we keep getting sucked into equity derivatives, as well. But it's supposed to be interest rate derivatives.

Now, at the moment, if you are a corporate in China and you need more funding, your choices are either to turn to the commercial banks to raise equity, either on the domestic stock exchange or internationally, or you look for a firm direct

investor. Plus, there are some corporate bonds. Four percent of all bonds in issue in China are called corporate bonds, but they're all bank guaranteed by state-owned banks, so they're really quasi sovereign bonds.

So we have embarked on this project at the present time and the Chinese are very keen on this also because it provides another investment product as they look to develop a long-term savings industry. So it's quite attractive. It also takes some of the heat off their banks as they prepare them for IPOs because it provides another source of funding to corporate participants. It highlights all the big issues about proper accounting, proper corporate governance. There are rating agencies in China, but they seem to give everything triple-A--

[Laughter.]

MR. LEIGHTON: --so I don't think that one has complete confidence that this is the way forward. So one of the things that we have made a big issue about is the development of proper rating agencies to acceptable international standards.

And obviously, the parallel derivatives, if this comes to pass, would have to be based on government bonds as the sort of benchmark and they don't have a complete yield curve profile in the issuing maturities of their government bonds, so we have said to them, you have to issue different maturities.

We plan to come up with our report in May of this year, the stage one of that report. I have just been, in fact, in China with Paul Boating, our Chief Financial Secretary, preparing for the meetings in London and talked to Mr. Li Hong, who is going to be representing the Chinese there.

So we feel quite positive about this. We actually--we have strongly encouraged foreign participation in their domestic markets, so all the points that you were highlighting earlier, we are completely signing the same tune.

It seems to me that they are quite willing to vary permissions and allow additional percentages. You put the caps on minority shareholdings. But if you've got a good case, you

can actually get quite a number of things through in their system.

COMMISSIONER LUKKEN: I wanted to ask Bob Pickel, representative from ISDA--I know they've been doing a lot of work in China--to sort of give an overview of whether there's any legal impediments that you've seen in China. I know we talk a lot about legal certainty here in the United States and still have the issue with legal certainty on occasion. The Enron case that's recently been in the news comes to mind. But if you wouldn't mind talking a little bit about China and what legal impediments there might be for the over-the-counter derivatives market.

MR. PICKEL: Yes. The two areas of focus that we have looked at in China have been the regulations that Secretary Quarles mentioned regarding derivatives licenses being granted, and there are roughly two dozen banks, foreign banks, that have applied for those licenses. That has been a significant step forward. They've taken an approach that is focused on putting in place good

risk management guidelines at the banks and, frankly, allowing the banks a fair amount of leeway to put things in place in the right way. So we thought that was a very positive development.

It is a CBRC regulation, and as was mentioned, that means that the securities firms cannot engage in the same way that the banks can in the derivatives business, and that's kind of the next threshold. I think there's a question as to whether the CSRC, the securities regulator, really has the ability to grant the similar type of exemptions, but that's something that I know that the securities firms are quite interested in. We are. I know that the SIA has been working with the Treasury Department to raise some of those issues or ask them to raise some of those issues in their discussions with China.

The other thing that we always focus on is the netting, the close-out netting provisions of our master agreement. We have--our master agreement is used in China. There is a Chinese language version of it that has been floating

around. But still, the fundamental requirement is that in the bankruptcy or the insolvency proceeding regarding a Chinese entity, that the netting provisions be enforced in the same way that they are here in the States and in many other countries around the world.

There is discussion of changes to the bankruptcy law, the insolvency law, over in China. We have prepared a paper that has been sent to the authorities there laying out the questions that we have regarding the current state of the law and suggesting ways in which the bankruptcy law should be changed to recognize closeout netting and find that enforceable. We don't really have any clear indication as to whether or when that would happen. That kind of ties back to some of the comments made before about you just have to be there and stay on top of it and hope that at some place, things fall into place, and we'll continue to work on that front.

So those are the two areas of licensing and also the netting provisions.

COMMISSIONER LUKKEN: Anybody else?

[No response.]

COMMISSIONER LUKKEN: Well, with that, I thank our guests from Treasury for coming today. I think what we're going to do, I think they're taking off, so we might take a break right now to have a cup of coffee and stretch our legs and if anybody wants to talk to them before they take off, now is the time.

Why don't we meet back here in ten minutes and we'll start part two of the agenda. Thank you.

[Recess.]

COMMISSIONER LUKKEN: I think we're going to try to get started. Let's go ahead and take a seat and we'll get started. Let's go ahead and get started on the rest of the agenda.

As I noted in the beginning of our meeting, in June, at our first meeting of the modern GMAC, we talked about looking at the secured/segregated funds issue and other relevant bankruptcy issues on how customer funds are handled. Art Hahn, thankfully, stepped forward to

chair that Subcommittee. We had a meeting this morning and talked over the progress report of what's been conducted so far and it's very good information and good work that's been done on this issue. So without any more, I'll turn it over to Art.

PRESENTATION ON SEGREGATED/SECURED FUNDS

BY THE GMAC SUBCOMMITTEE ON BANKRUPTCY

MR. HAHN: Commissioner Lukken, thank you for giving us an opportunity to report. Fellow Commissioners, it's a pleasure to be here.

I think the first thing to mention is we worked diligently as a Committee, but we've had terrific support from the Commission and particularly at staff. They've performed a role of being an information and technical resource and it's been invaluable. They've saved us a lot of time. They've been very thoughtful and have been a terrific support for us, particularly Jim Carley and Mr. Wasserman have been just invaluable as we did our work at the beginning of the project. Andrea Corcoran was very helpful. We wanted to say

thank you to the Commission for that support.

The issue of the possibility of merging the seg and secured funds is very complex and I think everybody on the Committee is sensitive to doing something in terms of the regime that currently exists that might have unintended consequences or bad consequences. We want to be very careful in this complex area.

I start out there because our purpose, and one of the purposes in making the report today is certainly to be informational for the entire GMAC Committee but in a very, very earnest way to solicit people's thoughts and comments on what we're doing and how we're approaching it as we move forward, because as we found in our work, there were moments where we had an idea and we thought it was the absolute holy grail, we had solved all the problems, only to find when we dug in a little further that we had gotten it wrong and that we were going down a path that may not have been so wonderful.

And that same approach, though, of really

vetting it carefully, fully exposing all of our thoughts on the process, is the way we're going to continue to act as a Subcommittee, but it really will be important to solicit all of your thoughts so that at the end of it, if we're to be productive, we produce something that is really right.

We do have a tentative model for how the merger, at least in part of seg and secured, might happen. That model is just now emerging, as Walt suggested, at the end of our meeting this morning, and I'll lay that out for everyone. But I think it's important to understand kind of how we got to that point.

The way we organized ourselves was to split up into two subcommittees. The first was chaired by Dan Roth and their charge was to understand fully the risks that were attempted to be dealt with by the separation of seg and secured, but not to stop there, to say, okay, what risks are real? What are no longer relevant? And then what are possible solutions? Their charge was to get as

creative as they could with the solutions without necessarily concerning themselves immediately with whether they were or weren't workable. But the idea was to throw out any ideas that people had and twist them and turn them and see if there was something there.

The second Committee was headed by John Davidson and their charge was to think about, is this really an important thing to be doing? Is it worth the candle to put these together? Will there be savings? Will there be efficiencies? And secondly, to act as a real world, practical response to the ideas that the Roth Committee came up with and saying, you know, that's a great idea, but it'll take a million man hours to put that in place, or it really doesn't work, or you haven't thought about this. And John's Committee was very diligent on working to put together that piece of it.

What I'd like to do now is have each of these gentlemen report out the work of their Committee because I think the different steps they

went through may trigger some thoughts among some of you and also to give you a sense of how we're approaching the problem and then I'll bring it back to finish the report to you what this template is that we're going to use going forward to further explore and how we're going to be functioning.

So with that, I'd ask Dan to kind of describe the work of his subgroup.

MR. ROTH: Thanks, Art. Our subgroup included Bernie, Dan, and Joanne Medero and Jim Falvey, but I should also mention at the outset that we received a lot of additional assistance not only from the Commission staff, as Art pointed out, but Ann Polaski and Katherine Camp and Ken Rosensweig were all very supportive and very helpful in assisting the Subcommittee as we went through our discussions.

We started our discussions by really looking at the historical rationale for separating seg and secured back when the Part 30 regulations were adopted some time ago, I guess about 20 years ago or so, and again, the Commission staff was

helpful. We looked at some of those original concerns and realized they don't really apply so much anymore.

Back at the time, there was a requirement that all seg funds be held in dollar denominated accounts. That would be a problem if you were merging seg and secured. However, the Commission has subsequently amended its regulations and that's no longer an issue.

There was also a concern at the time that perhaps it would be an inappropriate risk to ask customers whose funds were held in dollar-denominated amounts to share the risk of currency fluctuations. But again, I think the Commission in the 20 intervening years has revisited that question and really with subsequent amendments to CFTC Regulation 149 it's not so much a continuing concern.

So we really turned our attention to the question of, just as Art indicated, what risks are there that customers trading on U.S. markets could suffer in any way as a result of the merger of seg

and secured.

We started by noting that under the applicable regulations, there are different regulatory regimes in place for the handling of customer funds that are in secured amount accounts versus segregated accounts. The regulations are just different and we recognized a couple of things immediately. Number one, that those regulations would have to be harmonized. Number two, that the task of harmonizing them was particularly--was at least possibly very complex. And that, number three, we should therefore immediately get rid of that job, and we did.

[Laughter.]

MR. ROTH: We assigned that to John Davidson's Committee through a piece of parliamentary procedure that we don't need to go into here--

[Laughter.]

MR. ROTH: --but it was successfully transferred to another venue and they've dealt with that and dealt with it very well.

We started talking, then, about the, again, the risks that a customer on U.S. markets could suffer a loss due to an insolvency that was triggered by events overseas and tried to identify ways of dealing with that risk, of limiting that risk. And we, in the course of our discussions, came up with a number of different approaches, and in no particular order, we discussed, for example, the possibility of creating a new subclass of customers under the Commission's Part 190 rules. We used as a starting point Framework 2 to Appendix B to the Part 190 rules, and I think we all know Framework 2 to Appendix B to the Commission's Part 190 rules.

[Laughter.]

MR. ROTH: I know we all thought Framework 1 was good, but Framework 2 is--

[Laughter.]

MR. ROTH: But we started that as our starting point, really, and pursued the idea of could you create a subclass of customers such that in the event of an insolvency, those customers that

made a decision to trade in the foreign market where the events unfurled would have their claims subordinated to the rest of the customers. And in that way, you could possibly limit the contagion. You could limit that risk, or at least focus that risk on those customers that made the decision to trade in those markets and try to insulate from that risk customers that were trading on U.S. markets, and that is an idea that I think has some appeal to it.

It has some appeal to it because if we can figure out a way to make it work, it would achieve the desired result of limiting the risks to customers trading on U.S. markets, and from an operational point of view, it has certain advantages to it. Of all the advantages to that approach, simplicity would not be one of them. It's, again, a very complex area, and having already transferred one complex subject, we felt we couldn't transfer another one.

[Laughter.]

MR. ROTH: So there's additional work that

needs to be done here and quite a bit of it. But I think going forward, that is one option that we would like to explore in greater detail, to really examine more fully what would be involved, how you would work out those subordinations, how the regulations could be drafted, how effective they would be in various types of scenarios.

So the idea of subclasses of customer accounts in the event of an insolvency was one idea that we have discussed and continue to pursue.

We also talked about the possibility of limiting the likelihood of a foreign insolvency affecting a U.S. FCM by basically in some way setting standards and limiting the markets or jurisdictions for which trading could be included in the merged seg and secured accounts. That could take a number of different forms, but the idea would be to identify types of markets where we think the risks of an insolvency might be greater and excluding those from the combine from the merged accounts, and that could take the form of, for example, at one end of the spectrum, limiting

the jurisdictions that could participate--for which trading would be included in the merged account to those jurisdictions where the clearing organization was a designated clearing organization, had been approved by the CFTC as a DCO.

Another version of that approach would be more akin with the 30.10 sort of regulatory regime, where the Commission would make a determination that there was a comparable regulatory regime in that particular jurisdiction, and therefore under a 30.10 type of approach, those jurisdictions that were found to have had a comparable regulatory regime could be included in the merged account. That would be another means of addressing the risks, not perhaps quite as operationally clean as the subclasses under the bankruptcy rule, but nevertheless, a basic approach that we have explored and will continue to discuss.

The third approach that we discussed was providing customers with an opt-out opportunity, so that customers that chose not to have their funds held in a merged seg and secured account would be

given the opportunity to opt out of that regime. That opt-out provision could also take one of several forms. Under one scenario, the customers would have the right to opt out and could--it could not be made a condition of doing business by the FCM that they opt in, so that the FCM would have to offer them the opportunity to have their funds held in a merged account or in a traditional seg or secured amount account.

The other variation on that theme would be that the customer would have the right to opt out but the FCM would have the opportunity or the right to make it a condition of doing business with the customer that he opt in, so that if the customer opted out, he would, in effect, be opting out of that FCM and could take his business someplace else.

We've been considering both of those options. Neither of them have quite the simplicity of operational issues that John's group has sort of been looking at, but again, it's one of the avenues that we've been exploring.

The fourth sort of customer protection issue that we've dealt with has to do with the possibility that customers could be harmed in an insolvency proceeding through the application of foreign bankruptcy law under a regime that perhaps doesn't give the same priority to customers, or in some way application of the foreign bankruptcy law would harm customers trading on U.S. markets.

When we're working our way through that issue, we tried to create a sort of a matrix identifying all the various variables that could come up in an insolvency scenario as far as where the assets are, who the insolvent person is, domestic clearing organization, foreign clearing organization. We listed all the variables that we could think of in a matrix and then quickly determined by looking at the matrix that the possible combinations of scenarios was way too many, that there would be over 100 different types of scenarios or combinations of those variables that you could put together.

But the one thing that we identified was

that regardless of the scenario, which of the various combinations of those variables that you came up with, regardless of which one you came up with, that it would always be better if the assets were held in the U.S., that if the assets were held in the U.S., that there was a greater chance that the U.S. bankruptcy laws would apply than otherwise. No matter what scenario you came up with, that was a truism, that if the assets were held in the U.S., we had a better chance of ensuring that U.S. bankruptcy law applied, which seemed like just a great idea until we figured out that it probably is completely impractical in that it would be difficult to require both foreign clearing organizations and perhaps even more specifically the foreign clearing brokers to maintain accounts in the U.S.

So that was one of those ideas that seemed to have some appeal and upon further examination seems maybe not to be so practical. But we still haven't completely jettisoned the idea because there's a possible variation of that theme that

would involve requiring U.S. FCMs to maintain in the U.S. certain excess funds to at least ensure that there would be a certain portion of the funds that would be held in the U.S. and perhaps limit the application of foreign bankruptcy laws under that sort of scenario.

So that's an idea that's still also very much under discussion. The initial idea that we had, we think is particularly impractical, but there may be a variation of it that could at least give partial effect to what we were trying to achieve there.

So those were really the protection issues that we sort of identified. Those were some of the various alternatives that we have discussed. As I mentioned, the subclass of customer accounts under the bankruptcy code is an idea that continues to have some allure for us. I think all of them need to be examined a little bit further. But that's the state of our discussions on those issues as of this morning, Arthur.

MR. HAHN: A terrific job, Dan, and we're

all very grateful for your kind of pulling that effort together and kind of the open-mindedness and flexibility with which your Committee approached it.

I wanted you all to kind of hear that in some detail because you can think of some of the threads that we're looking at. If you've got a variant on that, the way we're doing our business is we're open to hearing that or listening to a good idea.

John, could you give us a sense of how your Committee worked your issues?

MR. DAVIDSON: Sure. Thank you very much. The first task of our Committee, of course, was to get out our old moldy dog-eared copies of Roberts Rules of Order and figure out exactly which parliamentary ploy it was that Dan's Committee used to give this to us--

[Laughter.]

MR. DAVIDSON: --and we searched diligently through that document and discovered that it was not a documented parliamentary ploy.

It's, in fact, something from the Chicago Bears playbook which they were very good at this year. They fell back and punted.

[Laughter.]

MR. DAVIDSON: So our Committee had two tasks. One was to develop a business case for arguing for a change of this nature and then evaluating some of the operational and practical impact of some of the potential solutions that might also serve the risk management interests that Dan has elaborated.

The first question with respect to a business case is are we dealing with a material issue here, and I think it's fairly clear that that is, in fact, the case. There are on the order of \$100 billion worth of customer funds in the U.S. futures industry and approximately 20 percent of them are in secured-amount deposits. So it's certainly a material question to look at, do you need to have that distinction.

And then in looking at sort of benefits that we would cite from merging these two pools,

there essentially came down to two types. One, if you will, are soft benefits and one are somewhat harder or more quantitative benefits. The soft benefits basically arrive out of the fact that this distinction between segregated funds and secured amounts is a distinction that's unique to futures commission merchants.

Customers do not organize their finances in that way. A customer doesn't make the distinction between those two types of funds, particularly customers that participate in single currency margining, that is to say that they give their FCM a chunk of collateral and participate on a portfolio basis in a variety of markets. That collateral is all denominated in dollars and they leave it up to the FCM to engage in the appropriate currency conversions for them.

There's not a lot of evidence to suggest that this distinction is producing benefits on the customer level that customers really understand and appreciate and it adds a significant amount of complexity. It adds complexity to FCMs. It adds

work to FCMs. It adds noise in customer statements when they transfer funds to the wrong account at the FCM and have to move them back. It causes noise in their statement when a transaction is inadvertently booked to the wrong type.

All of those things are things which investors in other types of foreign markets don't have to experience. They're certainly familiar with the notion that if they participate in certain emerging markets or certain markets where there's limited currency convertability that they will have additional operational tasks. But the notion that to participate in markets in major European and Asia-Pacific currencies, that they ought to jump through additional operational hoops is not something that they face in most other types of international investments in which they participate.

So having a simpler and more easy to understand and explain to customers regime is a significant benefit, but as noted, a soft benefit.

We did spent quite a bit of time trying to

get our arms around some of those harder benefits in terms of costs and we did an analysis of the cost of this current regime to market participants. Naturally, the composition of our group was such that we were able to do that to the greatest extent with respect to the cost to FCMs, and so we looked at banking costs and we looked at additional staffing costs from having the distinction to be maintained and we found significant but certainly by no means material savings associated with merging the two pools of customer funds.

Obviously, all of that needs some more fleshing out. We need to have a specific proposal that we can look at as opposed to a host of proposals, and in looking at that specific proposal, we can add both the hard benefits that will arrive from that proposal, but also some information about the implementation costs since any change in system is not free. It wouldn't necessarily be complicated, but we need to see the specific proposal to determine that and we'll get there as time goes on.

The next thing we did was looked at these host of different approaches for managing the risk with respect to the merger of the secured amount and the segregated funds pool and Dan very nicely elaborated each of those. Fundamentally, the "keep it simple" proposition is the one which is most attractive here and we're trying to simplify an already complex situation. You're not going to get a lot of operational benefits out of adding additional complicating bells and whistles.

Another thing I think that was discovered in the process is that this notion of having a subclass of customers whose interests are subordinate to another class is critically dependent on there being assets to distribute at such time as an insolvency occurs. So this concept of different pools and subordination is importantly determined on how you calculate the amount of assets that you have against your obligations to customers.

Thanks to the help of some of our colleagues from the SROs, we did actually go

through and come up with a proposal to harmonize the calculation. The calculation of segregated funds sufficiency and the calculation of secured amounts sufficiency are out of sync in certain important areas and we've reached a set of recommendations which, of course, will have to be vetted against what the specific proposal is before they become final, but that was important work that the Committee did.

With respect to the question of things like a dual system, obviously, from an operational perspective, the more markets and the more currencies that you can include in the merged pools, the less complexity you have, so that if you just had a single market outside the United States that was part of the commingled pool of segregated funds and secured funds, you would not have moved very far, and if you had most of the major markets in Europe and the Asia-Pacific region included therein, the fact that there were a handful of emerging markets that were still in the old system would be operationally much more straightforward.

Finally, we talked about this concept of holding funds exclusively in the U.S., and while that's certainly a possibility for a U.S. FCM, it is very difficult to understand what would motivate a non-U.S. clearing organization or a non-U.S. carrying broker to hold funds in the U.S. Those organizations do not currently distinguish among U.S. and non-U.S. investors, and in fact, they may be prohibited from making that distinction under their own insolvency regulations.

But there is the possibility that with respect to the U.S. FCM, who in this scheme of U.S. FCM, foreign carrying broker, foreign clearing organization is actually the party that reaps the benefit, that party could, indeed, carry some amount of funds, particularly those funds which are used to cover deficits in the calculation of segregation-slash-secured amount customer fund requirements. Those could be carried in the United States, we believe.

So a lot of work to be done. The next stage is probably getting a specific proposal and

evaluating the costs and benefits of that. But certainly this is an area that is material to the business overall. There are significant benefits both from a soft side perspective of the marketplace, ease of access as well as cost savings to FCMs as well as to investors in making a change of this type.

MR. HAHN: John, thank you very much for helping, and to the members of your subgroup for helping on that.

As we go forward, our plan is this. While we will remain open to different, totally different ideas, because nothing is set yet by any means, we have concluded that we do want to flesh out this idea of a subordination of the foreign participation. So simply stated, we would do away with the distinction between seg and secured. You would have a single fund. But we would identify a class of funds that would be subordinated to the main class of funds in order to achieve the security goal that Dan identified.

Precisely how you would make that

categorization, that's our work. We have to really think about what would go in there, how you would scorekeep what went in there, what recordkeeping obligation there would or wouldn't be on a daily basis, on an ongoing basis, what currencies could or couldn't be in there, what markets would or wouldn't be covered by that.

But when we've explored this to the extent that we have so far, it feels currently like it's viable. We don't know the final answer and we might hit a stumbling block when we really delve into it. But we've concluded as a Committee that that's the path we want to currently explore.

We further concluded that functioning as two separate Subcommittees, although extraordinarily useful to this point, was a good starting point, we think going forward that we need to all work together and bring to the process simultaneously the insights of the operational people and the risk people, and so our meetings going forward will be as a Committee of the Whole, if you will.

Through that process, as we've done to date, we've invited extra people in to bear some of the workload, to give us their thoughts, and I want to reiterate that we're saying the same thing again. There may be exchanges or clearinghouses that have some insight into this. Roy Leighton was good enough to sit in on our meeting this morning and he was able to share some European perspective on that. We're anxious to have that.

We certainly need, when we really delve into this, to understand exactly the impact on the people on the front line and that will be the FCM community. So both the operation and legal people from the FCM community need to be fully part of this process.

It would be--the way we left it, Walt, was that we would have a soft reporting date of the next GMAC meeting, but we said to ourselves that it's more important to get it right than get the thing out quickly. We're going to aim at trying to report back next time, but it may take longer as we delver into it further.

I think that's our Committee's report and we're certainly--we would invite questions at this point or comments.

COMMISSIONER: I just wanted to thank Arthur for his exceptional leadership on this issue and having to deal with people's schedules and getting folks together and without much in return, so we appreciate Arthur and also John and Dan for all the leadership they've taken on this issue.

I would want to point out, in case people are getting nervous that this is going too fast and we haven't been privy to this and what's going on, the role of an Advisory Committee is to, on these types of technical issues, to bring transparency. That was the point of the Federal Advisory Committee Act--to bring transparency to the process so that people have input into recommendations to the Commission. What this group is working on is to provide, with the input of all of you, these new recommendations to us.

Having said that, once these

recommendations are made to the Commission, we don't have to necessarily accept them, or if we do accept them, they will go out for notice and comment and more discussion. So for folks that haven't been privy to this, as Arthur said, we welcome your comments, your input. This is moving along in a very rational fashion and we certainly are willing to sit down with you at length and talk about these issues more if you'd like an update.

With that, I'll turn it over to questions that others may have in the audience.

MR. FILLER: Thank you, Walt. Arthur or Dan, I have two questions. My first question is, as you explore the various options emerging seg and secured, any relief or approaches that you come up with, any final conclusions or recommendations, can they all be implemented by CFTC rulemaking or does it require or may require legislative action?

MR. HAHN: A very good question. The current feeling--but nobody's really dug in deep on this, Ron, so we reserve the right to change our position--is that it may well be able to be done by

changes in the 190 rules and that it could be done that way, but we're not going to feel bound by that. We're going to try to come up with something that makes sense, that would really bring a benefit and bring the protections that we're starting with, and if that requires Congressional action, then we'll say so. We're not going to shoehorn it. We're going to come out with the best solution we can and then ask your question.

MR. FILLER: And my second question is, which obviously would require legislative change and a little bit more bolder approach than merging seg and secured is merging seg and SIPC. Has the Committee been looking at that issue at all or there's just more focus on the secured seg type concept?

MR. HAHN: A whiff of that has gone through the room on occasion--

[Laughter.]

MR. HAHN: --and we thought about things, how this might make it easier for portfolio margining, but we're not smart enough or brave

enough to fully tackle that. What I do think, though, is that if we solved this problem, okay, what would emerge would be much more suitable for looking at the issue you're addressing. So let's take it incrementally. We think it would be a step that could be built on if that was what the people's desires was. But we don't view that as our charge.

MR. BERLIAND: Richard Berliand from J.P. Morgan. First of all, Art, I think this is a great initiative and trying to find, gain standardization across the globe is hugely appealing to customers. I've got two sort of thoughts that I would add in here that I think are important framework, sort of background ideas.

One is that if you look at the client base, I don't think you will find more than five percent of the clients that we deal with that have a clue about this and the implications of this. The educational aspect of what we're doing here, I would argue that clients don't understand what exists today. The more complex we make what

replaces it, the more the educational challenge is, and I think that we have a responsibility to the users in the marketplace to make sure that whatever we do here is understandable and that we do proactively educate the clients in using that.

The second thing is something which Sharon has heard me say on a number of occasions, is to remember that as U.S. FCMs, we have a very significant number of clients who are not U.S. domiciled. Now, we know that the U.S. domiciled clients can hardly swim off to London and start signing up in London to do their U.S. business. The Part 30 exemption won't work there. But the fact remains is we have a lot of non-domestic customers who very much can choose whether they sign up with a U.S. FCM or whether they sign up with an FCM in some other jurisdiction.

Therefore, what we do today has significant tax dollar, economic implications on what happens to our U.S. businesses and, therefore, it's very important, for example, if we were to go down the subordination route, that we do not

produce a structure that makes a Cayman Island-based customer, for example, that is active in the foreign markets end up being subordinated in a position that they would not have if they were signing up under English law or some other environment.

So just a caution that everything we do is so connected internationally and such a high proportion of our clients truly can arbitrage the legal environments in which they work that we must keep that in mind. I don't think we want to see a wholesale exit of business to other jurisdictions, and certainly the Treasury won't, anyway.

MR. HAHN: Richard, you identify very clearly the thing that we figured out here, and that is that it is a very complex project and we're scared of unintended consequences, where we come up with a solution that satisfies prudential concerns or a solution that's operationally simple and then all of a sudden we realize that we distorted the market or the business in a way that we didn't intend and that isn't helpful.

To that end, I would certainly invite you and your colleagues to stay close to this process and say, hey, that solution you're coming up with, you didn't think about this, and I think that's the only way we're going to get it right and our goal, we'll just simply be as transparent as we can. We have thought about some of that, of who goes into that fund. Is it the Cayman company coming into the U.S. FCM? Is it the foreign broker who sends his business to the U.S.? How does it exactly work? We don't know the answer to that but we've identified the issue.

MR. PICKEL: The world of SCMs and segregated and secured funds is a little bit foreign to the ISDA world, but it sounds to me that part of the problem and perhaps some of the solutions you're thinking about are akin to some of the ring fencing type provisions that, like the New York State Superintendent of Banks has power to hold on to assets in New York for purposes of settling claims against the New York branch of a foreign bank.

And I just mention it because there is a case currently--we've weighed in with a brief--where there's a question of the interaction between the Federal bankruptcy law and particularly the ancillary proceeding provisions and the powers that the New York Superintendent of Banks has to hold on to those assets and there's a real question as to--the current ruling of the court is that the bankruptcy ancillary proceeding provisions override that State Superintendent of Bank power and we don't think that's the right solution, but I just mention that as background as you go forward with your work.

MR. ROTH: That's real helpful information and maybe we can talk with you later and get a little bit educated about that case and read some of those briefs.

MR. HAHN: One of--kind of along those lines, as Dan said, we went down a path for a while thinking that the ultimate solution would be to have these funds in the United States so that if there was a conflict between bankruptcy regimes,

you could glom them. That's a technical term.

[Laughter.]

MR. HAHN: And that, as John Davidson pointed out, is probably a little myopic and it doesn't work. But a part of that may, and we've explored, for example, the notion that excess seg or excess secured and the information we get is that as much as 12, 15 percent of the seg secured amount as a practical matter houses need to carry in excess. So if the number's right at \$100 billion, you're talking about maybe \$15 billion that the industry has to maintain to lubricate it all, to have in excess so that it doesn't find itself in violation.

Well, one notion if we put these together is that that \$15 million can stand as the cushion for both seg and secured. It makes the administration of this much easier. And we understand that you couldn't, as a practical matter, keep the whole \$15 billion in the United States because, again, you need to have some of the money offshore for certain kinds of immediate

purposes. But if as a general rule that excess was here, you'd go a long way to speak to some of the prudential concerns that we started our inquiry with. So that theme is still part of the mix that we're exploring. But it goes right into your case.

COMMISSIONER LUKKEN: I'll just add that the outline that Art has told us about going forward on this project--I think we can agree that there's consensus to go forward on this and visit this tentatively at our next GMAC meeting this summer, and we will work closely with you and your Subcommittee as it's merged back together to work on these issues.

On that front, I would like to thank Jim Carley and Bob Wasserman and also John Lawton, who have worked on these issues with the Subcommittee. They've added our Commission's expertise and I wanted to mention them at this time, so thank you again.

MR. HAHN: Thank you.

COMMISSIONER LUKKEN: Now we're going to turn to reauthorization, so we'll take off

our legal hats and put on policy hats. We're fortunate to have some old friends of mine sitting at the table. Andy Morton, who is Chief Economist on the Senate Agriculture Committee, has been handling CFTC issues for a few years now. And Dave Ebersole, who at one time worked at the CFTC and has been at the House Ag Committee for many years and is good counsel over there on these issues, as well. I was going to turn it over to them to give us a briefing on what we might expect this year on reauthorization. So Andy?

UPDATE ON THE CFTC'S REAUTHORIZATION
BY HOUSE AND SENATE STAFF

MR. MORTON: Thanks very much. It's a pleasure to be here today. I want to thank Commissioner Lukken for inviting me to join--for your invitation for me to join you today and make a few remarks, not too many, but a few about CFTC reauthorization.

I also want to take the opportunity before I do make those remarks to congratulate Chairman Brown-Hruska on her new position and also on her

confirmation late last fall for a second term as Commissioner. In that same vein, I want to congratulate Commissioner Hatfield and Commissioner Dunn on their confirmations through the Senate, as well. We had a busy end of Congress last fall.

I know a number of the folks here on this Committee and other people who are in the room today. There are others that I haven't had a chance to meet yet or just met for the first time today. I'm looking forward to meeting and interacting with all of you as we go forward in the Senate with CFTC reauthorization this year.

Senator Saxby Chambliss of Georgia officially became Senate Agriculture Committee Chairman on Thursday, January 6, just a few days ago. He replaces Senator Thad Cochran of Mississippi, who has moved on to become the Chairman of the full Senate Appropriations Committee. As I think most of you know, I work for Senator Cochran and I worked on CFTC issues during his tenure during 2003 and 2004. I think I've learned quite a bit. I'm still moving up the

learning curve and I know that you folks can all help me continue to do that.

The Agriculture Committee has a total--in the new Congress, with our membership now confirmed, we have a total of 20 members, 11 Republicans and nine Democrats. Senator Harkin of Iowa serves as our Ranking Minority Member and he has for a number of years and he's also a former Chairman of our Committee. Many of our members have served on our Committee for a substantial period of time, but we also have the pleasure this month to welcome three new members to our Commission, and those new Senators are Senator Craig Thomas of Wyoming, Senator Rick Santorum of Pennsylvania, and Senator Ken Salazar of Colorado. So we have a very excellent group and we have a busy agenda ahead of us.

Chairman Chambliss's first task as Agriculture Committee Chairman right out of the gate was to hold a confirmation hearing for the President's choice for the new Secretary of Agriculture, Governor Johanns of Nebraska, and that

hearing occurred late last week, as well, actually, the same day that Senator Chambliss officially became Chairman of our Committee. The hearing went so well, in fact, that the Committee went on to approve and to report out the Governor's nomination for Secretary to the full Senate unanimously, and that's actually a very rare occurrence, but it happened in this case and we're proud of them for that. So the Governor's nomination for Secretary of Agriculture as well as other cabinet-level nominations will be--I'm not sure it will happen immediately when the Senate comes back later this month, but it's certainly going to be near the top of the agenda for the full Senate.

The Chairman is in the process of organizing his Commission staff and planning the Commission's agenda for the year, and that process has really just begun. Very soon, we are going to be reviewing in quite a bit of detail the President's fiscal year 2006 budget proposals, particularly as those proposals relate to programs before our Committee. We'll also be monitoring

multilateral agricultural trade negotiations and related issues that are under discussion and are taking place under the auspices of the World Trade Organization.

I mention these other issues in addition to CFTC authorization, which is also in our Committee's jurisdiction, because the Agriculture Committee has a very heavy agenda this year. We're going to be busy on a lot of fronts and it's going to be quite interesting and a great deal of work.

As Commissioner Lukken mentioned previously, the Commodity Exchange Act, which authorizes CFTC to regulate the nation's futures exchanges, is in the Senate Agriculture Committee's jurisdiction and CFTC itself, the agency whose operating budget is annually appropriated by the Appropriations Committee, is due to be reauthorized later this year. I believe Walt said that September 30 is the date, and that's correct.

Periodic reauthorization of CFTC gives both our Committee and the House Agriculture Committee a chance to review CFTC operations and,

if they choose to do so, make changes in the underlying Commodity Exchange Act.

At this point, it's really too early for me to tell you how Chairman Chambliss will approach this issue this year, but I can report to you that he is not a newcomer to these issues. He was a member of the House Agriculture Committee in 2000 as the Congress considered and ultimately passed the Commodity Futures Modernization Act of 2000. He was then and remains to this day a strong supporter of CFMA and its general theme to move away from prescriptive rule-based regulatory approach and towards a more flexible approach based on core principles.

I should also mention that Senator Chambliss, when he was in the House, he supported former CFTC Chairman Jim Newsome's proposal to provide pay parity for CFTC, and, of course, that was enacted as one of many provisions in the 2002 Farm Bill, and I think that authority has served CFTC well so far.

On behalf of Chairman Chambliss, I would

like to also say simply that we look forward to working with all of you, the CFTC, with all the Commissioners, Chairman Brown-Hruska, the staff, all of you folks on this Committee, and the broader futures market community as we proceed with reauthorization. I'm sure we'll be keeping in touch.

If you have any questions that I can answer today, I'll do my best to do so.

COMMISSIONER LUKKEN: Thank you, Andy. As he mentioned, Chairman Chambliss is a friend of our agency's. For CFTC staff sitting around the room, he's the father of pay parity, which brought our salary levels up to comparable levels with other financial regulators, so we have much to be thankful for with Chairman Saxby Chambliss. And also, his son worked for us for a little period of time, Bo Chambliss, who may still be here, I don't know. He may be one of the best hires we've ever had in retrospect.

[Laughter.]

COMMISSIONER LUKKEN: Anyway, with that,

I'll turn it over to Dave Ebersole who will give us the House side perspective.

MR. EBERSOLE: Thank you, Commissioner. It's a pleasure for me to be here this afternoon. Madam Chairman, thank you very much for sitting here and listening to us. It's always good to follow the Senate. We're going to be doing everything they're going to be doing.

[Laughter.]

MR. EBERSOLE: But we're going to do it in a more relaxed way. Really, nothing is going to be happening in the House Agriculture Committee probably for at least the first of March. Our Committee is not organized. In fact, we have not heard from the Republican leadership exactly who makes up our Republican members. The Democrats are even further behind that schedule. So it appears at this point in time that the Democrats will organize late in the month and that we will set a schedule probably for a couple of hearings in the Subcommittee of Chairman Moran that probably would begin sometime in early March.

Now that I've said that, I should advise you, Madam Chairman, that knowing that you now have four Commissioners to vet your statement, you might want to expect an invitation to come up early in February for a hearing.

We are on a schedule that has not been set and we have not really sat down with any of our members to decide what that schedule may be. We do know that Chairman Bob Goodlatte from Virginia will still Chair the full Committee. Chairman Jerry Moran from Kansas will Chair the Subcommittee on Risk Management. We have a new Ranking Democrat, Colin Peterson from Minnesota. And beyond that, it's pretty much up in the air as to who will make up the Risk Management Subcommittee. That's where the initial work will be done and probably most of the work will be done on the reauthorization.

It would be good if we could do a simple five-year reauthorization of appropriations and be done with it, but that may not occur.

You're all welcome to come to our Committee offices on the third floor of the

Longworth building. Just drop in and say hi and come on back and talk to us.

I'm going to leave it at that and appreciate your allowing me to come down and fill in for Tyler Wegmeyer, who is Mr. Moran's staff person. If you have any questions, I'd be happy to try to answer them. Thanks.

COMMISSIONER LUKKEN: Does anybody have any questions for our friends from the Hill?

MR. LEIGHTON: May I?

COMMISSIONER LUKKEN: Mr. Leighton?

MR. LEIGHTON: As a European, a guest here, can I just say, and it's not just because I'm sitting here, but it's worked very well and the European perspective in dealing with U.S. regulators is that the CFTC is by far the most straightforward to deal with, the most internationally minded, and the one that we feel extremely comfortable with. So I encourage you very much in getting on with this process in reauthorizing them.

[Laughter.]

MR. LEIGHTON: I would just like to--I come from an environment of a single regulator, which I think is a long way away here in the United States, but I'd just like to ask you what you think about over-the-counter commodity derivatives, because in finally working out the risks in what FCMs and practitioners are doing out there, there's a greater and greater need to net things off with each other where it is appropriate to net them off. In the system that I am accustomed to, that is quite easily achieved because the regulation of these is exactly under the same hat. Whether you are a bank or a commodity house or a securities firm, you can deal in commodities if you have the necessary permissions, but net your exposure. I'm just interested to know what the prospects are for that in the future.

MR. EBERSOLE: I would seriously doubt that we will move any further, at least in the regulatory regime that's now set within the--it was basically set in 2000 with the CFMA. In fact, there have been problems in some markets that we've

been hearing about recently where some of our constituents are, I guess they're not all of the same mind but are basically saying that we need to look at some re-regulation of what was done in the year 2000. So moving any further away or toward any more efficient relationship between the off-exchange and the exchange environment, I'm not sure is going to happen anytime soon as long as the Ag Committees have jurisdiction, anyway.

MR. MORTON: I would tend to agree. I don't see, certainly at the moment, any significant change in our regulatory approach as far as how we have written the underlying Commodity Exchange Act. Under Chairman Cochran's tenure, we had, I believe it was in May last year, we had an oversight hearing on the implementation of the CFMA and Jim Newsome was the sole witness. And from his perspective, and I tend very much to agree with him, the CFMA has been a major success. The markets are growing.

I think from my perspective as our Committee's Chief Economist, as I've watched our

economy grow and develop and become more integrated with the rest of the world, over-the-counter derivatives are an extremely important development in the well functioning of our capital market, and indeed the world capital market. Maybe to put it more simply, I think there's a general view among folks perhaps in both Ag Committees to not try to fix something that isn't broken. Don't do any harm first.

CHAIRMAN BROWN-HRUSKA: I would just add, as well, that we're seeing a lot of positive movement in that direction by the markets themselves. In other words, we're seeing NYMEX working toward developing and having offered over-the-counter clearing and then realizing some of the benefits of some netting, maybe not operationally intermingling or commingling those funds, but finding ways to accomplish efficiencies in margining and the like. I was going to look over at you, Craig, because I know that from your perspective, you do a lot of business with swaps dealers. Swaps market users use your market significantly in the Euro dollars and other

products, and I'm just wondering, are there some some sort of abilities to attain margin savings within the limits of the current law? So the over-the-counter markets and the exchange-based markets, there are some of those kinds of mechanisms that we're seeing, aren't we?

MR. DONOHUE: [Speaker off microphone.]

Yeah. I mean, I think all of us are moving very much in the direction of expanding the range of instruments that can be combined into a single [inaudible] or other ways in which we could reduce performance bond and capital requirements. I do think that that's a trajectory that we're all on. I think apart from just the sort of capital and margin aspects of [inaudible] from our perspective, I very strongly agree with [inaudible] achieved a lot in 2000 in terms of enhancing both the OTC market and the highly-related exchange traded market.

[Inaudible] it's not necessary at this time [inaudible] think in any fundamental way what

I think was a great accomplishment [inaudible] beginning to serve us very well and I think [inaudible] around at what's been happening [inaudible] four to five years since that time, a lot of very positive developments, most of them, I think, evidencing a further integration [inaudible] markets along the lines [inaudible] suggesting. That process is not complete, but it's clearly a process that [inaudible] continue, I think.

I think the legislation as it currently stands [inaudible] sort of instigator, catalyst [inaudible] so I'm very strongly supportive [inaudible].

MR. PICKEL: I was just going to add that I think it's the other financial regulator that may create greater hurdles to achieving that greater integration of the exposures, because for regulatory purposes, and the SEC's got its regime, people need to do certain types of business through different legal entities which means you've got that hurdle basically from a corporate and bankruptcy law perspective of netting out exposures

across the different legal entities. And so that's going to be the bigger hurdle beyond what we've achieved since 2000.

MR. DONOHUE: By the time it's all over, Bob, you're going to be an expert on seg and secured funds.

[Laughter.]

MR. DONOHUE: You guys will actually be collateralizing and margining things.

MR. PICKEL: We're already moving in that direction.

MR. NANDAPURKAR: Thanks, Walt. I think there is a good lesson learned here when it comes to OTC markets, as you mentioned. When you look at the OTC markets and how we need to move forward with where we're at with globalization and the things we're trying to get done, I think one of the things that happened in the U.S. in the late '80s and early '90s was we let an opportunity get away with respect to the OTC markets and having some more certainty around the OTC markets.

Now, the CFMA and the CFTC has done a

great job in looking forward and the CFMA gave more legal certainty to the OTC markets and you've certainly moved the exchange markets along and allowed more integration to happen and you should be commended for that. But I think one of the lessons learned is that we kind of lost a marketplace there in the late '80s and early '90s and that marketplace has pretty much moved to London and a lot of the innovation in the OTC market is in London today.

So change happens very, very quickly and we've got to stay up with the pace of change, and I think it was unfortunately apprehension with the--I was in the early stages of my career in the OTC market back then and it was apprehension with the marketplace, probably entrenched forces that allowed that to happen. But now it's starting to come back, which is a very good thing.

COMMISSIONER LUKKEN: Speaking of our fellow regulator across the town, one question I wanted to flesh out with the group, during the CFMA, one of the things the CFMA allowed

was single-stock futures to be traded, and one of the provisions as part of that, not only domestically, was to develop joint rules with the SEC on broad-based foreign stock futures, but also narrow-based and single-stock foreign stock futures.

So those rules have never been written between our two agencies. Those products are, from what I read in our clips and the news clips that we see, taking off in Europe. So I wanted to sort of ask the group, why are these products taking off in Europe? What seems to be the impediment of why these markets may not be as successful here in the United States? It is margin? Is it the dual regulation? What are the issues that might be holding us back and how can we move forward on this foreign issue in regards to security futures products?

MR. BERLIAND: I guess like Ron, as a semi-European--Kevin, you're honorary, I guess--I think the laundry list of reasons has been debated at length in the press and I don't think there's

any real need to go through them, but the answer is all of the above have a significant impact. At the end of the day, there are certain things that are within the remit of this advisory group and those people who have the regulatory responsibilities that we can fix and there are those that we can't.

To me, looking externally into the U.S., the perceived biggest problem lies around the regulatory environment. To me, if I was running a commercial organization and the CFMA had enabled the two regulatory bodies to get together and write these rules, a commercial body would say, who is accountable for failing to deliver on this? And in a commercial organization, jobs would be at stake and so on.

The difficulty we've got here is clearly with the political aspects of it. It's all very well if there's one party who is extremely willing and the other party chooses not to come to the table. But I hope that the reauthorization process gives a strong forum for this to be debated as to why that element of the empowerment that the two

regulatory bodies had to write these rules is discussed and that there is some additional pressure applied from the House and from the Senate to actually achieve that.

I think the point that Satish made about innovation in Europe around this thing, I don't think single-stock futures were innovative in Europe necessarily and I think the debate occurred simultaneously across both regions. But I think the opportunity that is being missed here in the U.S. is going to grow by the year, and I think until we sort out the regulatory components, all other elements around the economic and commercial aspects of using these products will go nowhere. I really do hope that the reauthorization provides that platform for debate, and certainly certainly as a user, I couldn't encourage it more aggressively.

MR. HAHN: Kind of doubling back, and again, I don't know that it's the highest item on your priority list, but in the final days of the CFMA when it went through, when it accomplished, as

everybody said, a great deal, and we're all better for it, the fine points of the single-stock future and the foreign allowance wasn't buttoned down. My memory is that under the commodity legislation, at least as to foreign single-stock futures access in the United States, the feeling was to the extent that you could buy the underlying, you should be able to buy the option. That was in the commodity law.

It didn't find its way into the securities amendments, and as a consequence, there's no ability for U.S. broker dealers, FCMs, to offer those things to the public, albeit that in the commodity exchange laws, it would suggest that they should be. It was an outtrade, in commodity terms.

It might be something that could be addressed. It would be at least a half a step forward in getting the commerce going, and to the extent that you've got free flow of commerce, markets innovate and respond to it and you could get some things going. Certainly, the laundry list of problems that inhibited single-stock futures

would have to be addressed before they take hold more seriously in the United States. One Chicago is certainly doing a yeoman's job, but they're doing it with one hand tied behind their back.

COMMISSIONER LUKKEN: I guess we'll wrap up, then. I appreciate our friends from the Hill coming up to brief us. Be certain to grab them as they're leaving to introduce yourself, and if they need input in the future, I know that will be appreciated.

Before we leave, I would just like to thank a few people that helped put all this together, the other Commissioners and all their staff, Erin Shaw, Dave Stawick, and my staff, Lindsay Spiller from Commissioner Hatfield's staff, Loraine Leonard, and all the other administrative and support staff that helped put this together. Thank you so much.

I would invite members who are able to stay, who do not have to catch flights, to come up to the Chairman's suite to have a drink and converse with us. We would love to have you.

So with that, we'll see you next time, and
thank you very much.

[Whereupon, at 3:38 p.m., the meeting
adjourned.]