Testimony of
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NYSE Liffe U.S., LLC
on behalf of NYSE Euronext
before the
U.S. House of Representatives
Committee on Agriculture
Subcommittee on General Farm Commodities and Risk Management

Harmonizing Global Derivatives Reform: Impact on U.S. Competitiveness and Market Stability

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Chairman Conaway, Ranking Member Boswell, members of the Subcommittee. My name is Tom Callahan, and I am the Chief Executive Officer of NYSE Liffe U.S., LLC ("NYSE Liffe US"), a subsidiary of NYSE Euronext. The NYSE Euronext group operates 13 securities and derivatives exchanges in 6 countries.[1] NYSE Liffe U.S. is a futures exchange designated by the Commodity Futures Trading Commission ("CFTC") as a contract market ("DCM"). I am pleased to appear this morning on behalf of NYSE Euronext and its affiliated exchanges as the Subcommittee considers both the progress towards and challenges to international harmonization in connection with the implementation of the derivatives title of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").

We believe that the reduction of systemic risk and the enhancement of transparency through expanded use of clearinghouses and organized trading markets are important objectives. The adoption of these and related goals by the Group of Twenty ("G-20") countries is also a key and indeed critical element in enabling us to accomplish these objectives. As a multinational

[1] NYSE, NYSE Arca Equities, NYSE Arca Options, NYSE Amex Equities, NYSE Amex Options, NYSE Liffe, NYSE Liffe US, NYSE Blue, NYSE Alternext Equities, Euronext Paris, Euronext Brussels, Euronext Amsterdam, and Euronext Lisbon.

company with exchange operations in multiple countries, and customers located on every continent, we are acutely aware that effective international coordination is critical both to the accomplishment of Dodd-Frank's intended results as well as to the commercial success and competitive positioning of U.S. exchanges, clearinghouses and other market participants.

Effective global coordination will have the salutary effects of preventing regulatory arbitrage, improving market efficiency and raising the quality of regulatory oversight in all participating jurisdictions. Ineffective coordination of regulatory policy, however, will lead to market fragmentation. Where that occurs, U.S. end users and investors could be disadvantaged both in accessing foreign markets and in their ability to trade in liquid U.S. markets.

We believe there are three key dimensions to effective global coordination: first, working cooperatively to establish coordinated regulatory policy at the international level; second, establishing an appropriate framework for cross-border market access that does not require regulators to assume unrealistic and unduly costly extraterritorial regulatory obligations that they are not positioned to discharge effectively; and third, adopting a mutual recognition framework for comparable foreign regulatory regimes recognizing that comparable policy objectives may be realized through varying regulatory mechanisms.

We believe that the CFTC's traditional approach to recognition of comparable foreign regulatory regimes has worked well over the years, but we have some concerns that its proposals under Dodd-Frank would unduly depart from that approach. Before addressing those specific proposals, however, I would like to highlight two overriding principles that we believe should inform the CFTC's and the Securities and Exchange Commission's (SEC) implementation of Dodd-Frank:

- First, we believe that Dodd-Frank should not serve as a basis for the CFTC (or the SEC) to take on unnecessary and inappropriate extraterritorial regulatory obligations. Rather, Dodd-Frank should serve as a basis to supplement the CFTC's existing approach to cross-border market access through the use of new authorities to address clearly evasive activity. In this regard, extraterritorial jurisdiction is only appropriate where legitimate U.S. regulatory concerns exist, such as where foreign markets offer "look-alike" products that are linked directly to contracts traded on U.S. DCMs and that may be used to circumvent important U.S. regulatory objectives. However, any such exertion of extraterritorial jurisdiction should be narrowly tailored to preventing such circumvention. As a corollary, permitting U.S. investors to access foreign markets on an appropriate basis is critical if U.S. market providers are to be permitted to access investors outside the United States on appropriate and commercially viable terms.

- Second, it is critical that the CFTC, where possible, seek harmonization – or, at a minimum, comparability – with other regulators in implementing derivatives reforms. Significant differences with foreign regulators, particularly the European Union ("EU"), and domestically with the SEC, could preclude the establishment of an effective comparability-based framework for cross-border access. This will in turn encourage regulatory arbitrage that can only be addressed, at a significant cost to market participants, through steps that will invariably fragment markets regionally and foster illiquidity and increased costs of execution. Harmonization and comparability, in contrast, will protect the international competitiveness of U.S.

exchanges, clearinghouses and other market professionals and ensure U.S. market participants have cost effective access to critical risk management products.

1. Cross-Border Market Access

A. Access to Foreign Markets

Currently, U.S. market participants can access comparably regulated foreign boards of trade ("FBOTs") directly from terminals in the U.S. This access has been permitted by the CFTC under a long line of no-action relief. The NYSE Liffe markets in London and Paris have been open to U.S. market participants under this system since 1999, and the Amsterdam market has been open to U.S. market participants since 2005. Not only has this existing approval process proven effective at expanding the range of products available to U.S. market participants, increasing liquidity, and lowering costs, but it also has given the CFTC a great deal of flexibility in terms of tailoring relief to particular markets and modifying the conditions for such individual operations over time. This framework for cross-border access has worked well since its inception, benefitting U.S. market participants.

Dodd-Frank provided the CFTC additional flexibility in the form of discretionary authority to directly register FBOTs that offer terminal access in the U.S. While we appreciate that adoption of a rules-based standard may be useful as a supplement to the existing no-action regime, particularly for FBOTs that offer "look-alike" contracts that are linked directly to contracts traded on U.S. DCMs, we are concerned that replacing the no-action regime entirely with a registration requirement for all FBOTs offering access in the U.S. is unnecessary and unduly costly.

Pursuant to this authority, the CFTC has proposed to require the registration and oversight of FBOTs that provide qualifying U.S. persons with direct electronic access to their trading and order matching engines. The proposed approach would represent a striking departure from the CFTC's existing regime, which has been influential in encouraging other jurisdictions to look to comparable U.S. regulation as a basis for mutual recognition.

In particular, given the significant resource constraints the CFTC faces in implementing Dodd-Frank, the CFTC's proposal to require each existing no-action recipient to re-submit, and the CFTC to re-review, information that was already reviewed by CFTC staff in connection with the original approval seems especially unwarranted. It would also impose unnecessary costs and burdens on foreign applicants.

The CFTC's proposal, if adopted, would also set an undesirable precedent for other jurisdictions, such as the EU, which are considering permitting U.S. market operators to operate abroad on a mutual recognition approach.

B. Access to U.S. Markets

In the futures markets, the CFTC has traditionally allowed foreign market participants and intermediaries to access U.S. Designated Contract Markets "(DCMs") without subjecting them to direct CFTC regulation so long as they, like U.S. customers, access the DCM through a CFTC-registered futures commission merchant. While the CFTC has proposed to extend this approach to swaps at the intermediary level, there are still questions about whether a foreign market participant can trade swaps on a U.S. DCM or swap execution facility ("SEF") without becoming subject to regulation as a swap dealer or major swap participant. So that we can, in the future, offer trading in swaps on NYSE Liffe U.S. to both U.S. and foreign market participants –

thereby attracting the greatest amount of liquidity – we believe it is important for the CFTC to clarify this point.

2. Harmonization and Comparability

In order for any mutual recognition regime to work – and to avoid undesirable arbitrage between U.S. and foreign markets and different types of U.S. markets – regulators must take care to adopt consistent approaches to similar issues or at least recognize where different means can be used legitimately to achieve common objectives. These principles have, for over twenty years, been implicit in the CFTC's own approach to comparability under Part 30. We are concerned, however, that the CFTC's current proposals for DCMs, including ownership restrictions, might lead to an unwarranted departure from those principles; the approaches being proposed for the regulation of SEFs are inconsistent; and we also believe it is important that the CFTC coordinate with other G-20 jurisdictions on key aspects of reform, including clearing mandates and swap data repositories ("SDRs").

A. Designated Contract Markets

The CFTC has proposed a substantial overhaul of the core principles governing DCMs, including proposing to require a DCM to delist a contract that fails to maintain average trading volume through centralized markets of at least 85%. These changes are not mandated by Dodd-Frank and will likely have a significant negative impact on the competitiveness of U.S. DCMs. In the U.S., market participants may increase their trading in swaps that offer futures-like exposure, including on SEFs. In the EU, current reform proposals do not contemplate any such requirements, thus creating an incentive for derivatives trading to move offshore to European exchanges.

The proposed 85% central trading threshold is particularly problematic because it may inhibit the development of liquid markets in new products, which are often initially traded outside of centralized markets and often require more than the proposed 12-month grace period to establish adequate liquidity. Trading in these products will almost surely move to SEFs and offshore – thereby eliminating the still significant price discovery function played by block transactions that are executed subject to the rules of DCMs. The potential migration of these existing contracts away from DCMs seems completely contrary to the goals of Dodd-Frank and will likely have serious ramifications for market participants with open positions in affected contracts, disrupting effective risk management strategies by reducing contract liquidity and in some cases requiring market participants to hold existing positions to expiration. There are significant adverse market and risk management effects of applying an arbitrary and inflexible standard.

B. Ownership Restrictions

The CFTC is considering substantial restrictions on the ownership of DCMs and SEFs which may inhibit the creation of new DCMs and SEFs and have deleterious effects on market competition. These effects are magnified by the significant capital requirements for DCMs also mandated by the CFTC. Moreover, European regulators have not proposed similar ownership restrictions for exchanges operating in Europe, compromising the ability of U.S. and foreign exchanges to operate across borders in any future comparability-based cross-border framework.

We acknowledge that potential conflicts of interest can raise potentially serious issues and we applaud the CFTC for its leadership in addressing these concerns. However, we feel strongly that the consistent oversight of compliance with the existing core principles, CFTC rule approval requirements and other safeguards provide substantially better tools to mitigate potential conflicts than blunt ownership limitations that could stifle innovative solutions and new ventures. The market is too diverse to become subject to a one-size-fits-all approach to conflicts. Rather, different market models must be allowed to develop for different products. For these market models to develop in a successful and transparent manner, a broad range of market participants must have input. This will allow for greater competition and innovation in areas such as cross-margining arrangements and trading functionalities.

C. Swap Execution Facilities

The CFTC's proposal for SEFs has significant differences both with the SEC's parallel proposal and proposals in the EU and other G-20 jurisdictions. These differences may impair the competitiveness of U.S. markets, encourage trading elsewhere and restrict the effectiveness of any comparability-based cross-border regime.

D. Clearing Mandate

The timing and the scope of the clearing mandate for OTC derivatives in the U.S. should be coordinated with the rest of the G-20. As it currently stands, the clearing mandate for OTC derivatives will likely take effect in the U.S. prior to those mandates being established in other jurisdictions, potentially incentivizing swaps trading by market participants in foreign markets not yet subject to a clearing mandate. Moreover, eventually, cross-border swap transactions may be subject to clearing mandates in more than one jurisdiction, with potentially conflicting requirements. The CFTC should work together closely with foreign regulators to develop a framework for regulatory cooperation that avoids such conflicts. For instance, the CFTC should facilitate the clearing of swaps by U.S. market participants on clearing organizations outside the U.S. that are subject to comparable regulation, so as to foster reciprocal treatment from foreign regulators and promote an efficient, transparent global market.

E. Swap Data Repositories

Dodd-Frank requires Swap Data Repositories (SDRs) to obtain an agreement for indemnifications from foreign regulators before sharing information regarding swaps transactions. This requirement is contrary to existing approaches to information sharing and, in our view, unduly burdensome. Dodd-Frank also does not grant the CFTC express authority to exempt a comparably regulated foreign SDR, which is inconsistent with proposals in the EU and elsewhere. Left unaddressed, these issues will contribute to regional fragmentation of global information collection and impede the CFTC's exercise of its regulatory responsibilities under Dodd-Frank.

While we would support statutory changes to address these SDR concerns, we also believe that the CFTC could address them through its rulemaking and interpretive authority. The CFTC could, for instance, address the indemnification issue by interpreting the indemnification provision not to apply where information is provided, either directly or through the CFTC, pursuant to a CFTC Memorandum of Understanding with a foreign regulator. The CFTC could also adopt a notice registration regime for comparably regulated foreign SDRs that fulfills the statutory mandate without requiring the CFTC to directly regulate SDRs already regulated abroad.

3. Conclusion

We recognize that the passage of Dodd-Frank has placed enormous resource burdens on the CFTC, and we commend the CFTC and its staff on their proactive and timely efforts to nevertheless implement the many required rulemakings under Dodd-Frank. As a globally integrated company whose operations are often subject to overlapping regulatory regimes and requirements, we are particularly concerned about a number of CFTC proposed rules that would impede appropriate cross-border market access by U.S. or foreign persons as well as those that may thwart the development of comparability-based mutual recognition or exemption regimes. We have highlighted a number of these concerns today in this testimony.

Going forward, we strongly believe that the CFTC should develop its final rules under Dodd-Frank, as well as utilize its other rulemaking and interpretative authorities, in light of two primary objectives. First, the CFTC should not view Dodd-Frank as an opportunity to expand extraterritorial application of U.S. law – or to establish the need for resources to administer a global examination and supervisory reach – unnecessarily, especially in light of the significant resource constraints the CFTC already faces and the history of successful comparability regimes. Second, the CFTC should seek actively to harmonize its derivatives reform rules with the SEC and with regulators in other G-20 countries in order to discourage regulatory arbitrage and facilitate the development of comparable international regulatory frameworks and to avoid market fragmentation and other inefficiencies.

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Prior to joining NYS Euronext, Mr. Callahan was the Head of Global Financial Futures and Options at Merrill Lynch where he was responsible for global listed derivatives for debt, equity, FX and commodity products.

Mr. Callahan held various leadership positions during his 15 year tenure at Me Merrill Lynch, in both New York and London, including: Head of Global Debt Financing, Co-Head of Global Prime Brokerage, Head of European Vanilla Interest Rate Trading and Sales, Head of Global Money Markets Trading, and Senior Trader in ML Government Securities, Inc. Prior to that, Mr. Callahan worked for Prudential Securities, where he began his career in 1992.

He is a 1991 graduate of Harvard University.

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Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2008.

Name: Thomas F. Callahan

Organization you represent (if any): NYSE Liffe U.S.

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2008, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source:______________________ **Amount:**__________

Source:______________________ **Amount:**__________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2008, as well as the source and the amount of each grant or contract:**

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Please check here if this form is NOT applicable to you: ✓

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