

February 11, 2009

The Honorable Maria Cantwell
United States Senator
511 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Cantwell:

I am writing in response to your series of questions regarding my nomination to be Chairman of the Commodity Futures Trading Commission. I appreciate your meeting with me on January 15 and your leadership on the many issues facing the Commission. Please find my responses attached.

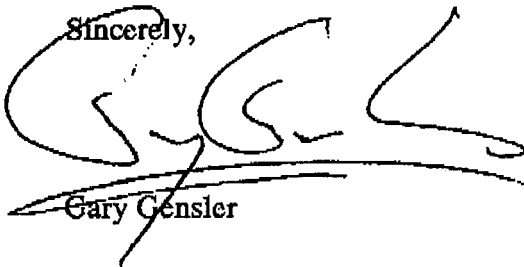
I believe the CFTC must vigorously fulfill its mandates: enforcing existing laws aggressively, promoting market integrity, preventing fraud and manipulation, and guarding against excessive speculation.

We also are at a transformational time that requires bold leadership to strengthen our regulatory system. The American public and our economy benefit from strong, intelligent regulation. We must apply the hard lessons we have learned to repair our regulatory system and to enact far-reaching rules that promote transparency, accountability, fairness, and safety.

If confirmed by the Senate, I look forward to working with you on much needed regulatory reform. I believe we must enhance the CFTC's ability to guard against excessive speculation in commodities markets. Furthermore, I believe we must urgently move to enact a broad regulatory regime for the over-the-counter derivatives marketplace.

Should you have further questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read 'G. Gensler', written over a horizontal line. The signature is stylized and somewhat cursive.

Gary Gensler

Please Explain your work at the Treasury Department

- 1. In your capacity as an Undersecretary at the Treasury Department, you worked on the November 1999 Report of the President's Working Group on Financial Markets report on *Over-the-Counter Derivative Markets and the Commodity Exchange Act*. What specific part, if any, of this report do you disagree with today?**

We have learned a great deal in the nearly ten years since the President's Working Group on Financial Markets' report was published. Capital markets have been transformed by new financial products, the increased use of asset securitizations and 'off balance sheet' financings, the development of fully electronic markets, the significant participation of index and hedge fund investors in commodity markets, and other financial and technical innovations. We also have witnessed the harsh aftermath of Wall Street's excess leverage and risk taking, mortgage originators' weak underwriting practices, and rating agencies' shortcomings. Our financial system and our regulatory system both have failed the American people.

I believe that we must move swiftly now to apply the hard lessons we have learned. We must repair our regulatory system and enact far-reaching rules that promote transparency, accountability, fairness, and safety. To be effective regulations must adapt and stay abreast of developing technologies and new products. I firmly believe that the American public and our economy benefit from strong, intelligent regulation.

First, we must ensure that the CFTC is revitalized in order to vigorously enforce existing laws and fulfill its mandates: to promote market integrity, to prevent fraud and manipulation, and to guard against excessive speculation.

Second, we must enhance the CFTC's ability to guard against excessive speculation in commodities markets. I believe that all physical commodities futures, including agricultural, metals and energy, should have consistent regulation under the Commodities Exchange Act. I also believe we must increase the CFTC's ability to guard against excessive speculation by increasing transparency around index and other non-commercial investors, reviewing all current exemptions from position limits, and ensuring that position limits are applied consistently across all markets and trading platforms. If confirmed by the Senate, I look forward to working with Congress to achieve these objectives.

Third, we must urgently move to enact a broad regulatory regime for the over-the-counter derivatives marketplace that best promotes transparency, accountability, and safety. If confirmed by the Senate, I look forward to working with Congress to bring all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establish a statutory and regulatory framework for derivatives dealers,

formulate appropriate oversight for bilateral customized derivatives, and consider further additional regulation for credit default swaps.

Finally, as this crisis has powerfully demonstrated, we must work more closely with our international partners on all of these issues. Today's complex financial markets are global, and as we have seen, absolutely and irreversibly interlinked. We need to ensure that our partners in regulating markets around the world apply the same rigor in enforcing standards of transparency, accountability and safety for investors that we will demand of our markets. If confirmed, I look forward to working with Congress and international regulators to achieve these goals.

2. As an Assistant Secretary and Under Secretary of Treasury in 1998-2001, did you oppose the regulation of over-the-counter swaps and derivatives by the CFTC? What specific actions did you take in this regard?

During 1998, I was not involved in these matters, which occurred primarily during the spring and summer. This was during my first year at the Treasury Department and I had been advised by Treasury Department Counsel that I was recused from these particular matters since they might relate directly to my former employer. The subsequent drafting and passing of the Commodity Futures Modernization Act (CFMA) legislation was a lengthy and complex process, involving at least four government agencies including the Federal Reserve, the SEC, the CFTC and the Treasury Department. Hearings were held in front of at least five Congressional Committees. As I was no longer subject to the restrictions of recusal in 2000, I was a member of a team that worked with and advised then-Treasury Secretary Lawrence Summers on Treasury and the Administration's positions.

3. In your capacity as an Undersecretary at the Treasury department, did you work to enact the Commodity Futures Modernization Act of 2000 (CFMA) which specifically exempted swaps from CFTC regulation? Did you intend to exempt credit default swaps from regulation as part of the CFMA?

I was a member of a team that worked with and advised then-Treasury Secretary Summers on Treasury and the Administration's positions. At the time, the vast majority of over-the-counter derivative contracts were interest rate and currency swaps, constituting 97% of the market. These swaps made up 29 out of 30 derivative transactions in those days. The bulk of those remaining were equity and commodity derivatives transactions. Credit default swaps were an insignificant product at the time and not a focus during the legislative process.

4. Do you still support the policy to exempt swaps from regulation by the CFTC? Has your opinion changed?

As I have previously stated, I believe we must enact a broad regulatory regime for the over-the-counter derivatives marketplace that promotes transparency, accountability, and safety. If confirmed by the Senate, I look forward to working with Congress to bring all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establish a statutory and regulatory framework for derivatives dealers, formulate appropriate oversight for bilateral customized derivatives, and consider further additional regulation for credit default swaps.

5. To what extent to you believe the enactment of the CFMA contributed to the current financial sector crisis?

I believe that both our financial system and our regulatory system failed the American people. There were many elements that contributed to these failures. To repair and reform the system, we must apply the hard lessons we have learned and tackle a robust agenda including modifying regulation of mortgage origination and securitization, credit rating agencies, hedge funds, over-the-counter derivatives markets, and capital rules and counterparty risk standards. Additionally, we must improve systemic regulation, increase transparency, and put new protections in place for investors, consumers, and farmers.

I believe we must enact a broad regulatory regime for the over-the-counter derivatives marketplace. If confirmed by the Senate, I look forward to working with Congress, the Administration, and other regulators to amend the Commodities Exchange Act and create regulatory oversight for the over-the-counter derivatives market that best promotes transparency, accountability, and safety.

6. To what extent is unregulated trading in credit default swaps responsible for the current financial crisis?

I believe that many factors contributed to the current financial crisis. One of the significant lessons we have learned is that unregulated derivatives dealers, many of which were affiliates of broker dealers, threatened and in some cases destroyed their parent or affiliate, causing global shockwaves.

This was the case in AIG's failure, for example. AIG, a leading global insurance company, with many state regulated insurance subsidiaries, had an unregulated capital markets and derivatives affiliate, AIG Financial Products. This unregulated affiliate developed a significant credit default swap business. By June, 2008, they reported having a \$447 billion net notional amount of credit default swaps. Approximately two thirds of this was written to support regulatory capital of major banks, primarily in Europe. The other third was written largely in support of asset securitizations. Regulators failed to institute appropriate oversight for this unregulated dealer and others like it. Global regulators also failed to keep pace with this new and rapidly growing market, and systematically serious consequences resulted.

While serving at the Treasury Department as the Under Secretary for Domestic Finance in the late 1990's, as part of the Treasury team, I advocated for regulation of the then unregulated derivatives dealers affiliated with brokerage houses. I feel even more strongly that this is the right course of action today. If confirmed by the Senate, a high priority for me will be working with Congress and other regulators on a statutory and regulatory framework for all derivatives dealers including appropriate capital requirements, business conduct standards, and other rules.

Furthermore, if confirmed by the Senate, I look forward to working with Congress on considering further regulations for credit default swaps. This would be in addition to bringing all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establishing a statutory and regulatory framework for derivatives dealers, and formulating appropriate oversight for bilateral customized derivatives. Credit default swaps have a close relationship to corporate bonds and other securities. Credit default swaps also were used by some banks to manage their bank capital requirements and to structure asset securitizations. Given these unique characteristics of credit default swaps, I believe multi-agency regulatory review and cooperation will be necessary in working with Congress to design possible new federal regulations specific to these products.

7. Do you believe all credit default swaps should be subject to mandatory clearing on a prospective basis? Or do you prefer a policy of voluntary clearing?

I believe that all standardized over-the-counter derivatives, including interest rate, currency, equity, commodities and credit default swaps, should be brought into mandated centralized clearing. As I have discussed above, I believe that further regulations for credit default swaps should be considered in addition to bringing all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establishing a regulatory framework for derivatives dealers, and formulating appropriate oversight for bilateral customized derivatives.

8. Should existing credit default swaps be subject to mandatory clearing?

I believe this is an important issue not only with regard to credit default swaps, but for all outstanding over-the-counter derivatives. Bringing standardized over-the-counter derivatives into mandated centralized clearing could ensure for the daily valuation of transactions through mark to market accounting, enhance the soundness of the system by requiring the timely posting of collateral, and increase transparency into dealers' total aggregate trading positions by underlying commodities.

Most existing over-the-counter derivatives contracts, however, were entered into on a bilateral basis. In addition, a review of publicly available data suggests that the majority of outstanding mark-to-market exposures for derivatives dealers have not been fully

collateralized. To do so would require significant additional resources and capital for the major banks.

If confirmed by the Senate, I look forward to working with Congress and other regulators to consider this important question and how to best achieve the benefits that mandated centralized clearing of existing over-the-counter derivatives could provide.

9. Which agency should Congress designate as the regulator of organizations which will clear credit default swaps: the CFTC, the Securities and Exchange Commission (SEC) or the Federal Reserve?

The CFTC has a well established record of successfully overseeing and regulating derivatives clearing organizations in the US. In my view, this experience makes the CFTC best suited for overseeing central counterparty clearing of credit default swaps.

10. Should credit default swaps be regulated as insurance? If so, should this be state based regulation or federal regulation?

Some credit default swaps have insurance-like characteristics. For example, AIG Financial Products, the unregulated affiliate of AIG discussed above, was writing credit protection for European banks and asset securitizations. This shared many characteristics with the bond insurance protection being written at the same time by monoline financial guarantee insurers like MBIA and AMBAC. Given this and other unique characteristics of credit default swaps, I believe multi-agency regulatory cooperation will be necessary in working with Congress to design possible new federal regulations for these products.

11. What is the social benefit from naked credit default swaps (e.g. the entity does not own the property that is covered by the swap but is simply speculating on the failure of an institution or governmental unit)? Should “naked” credit default swaps be outlawed altogether? If not, why not?

Naked credit default swaps, particularly those related to single issuers, have many attributes of a short sale of a corporate bond. Approximately half of the current credit default swap marketplace relates to single-issuer credit default swaps. Congress is currently considering legislation that would ban naked credit default swaps. If confirmed by the Senate, I look forward to working with Congress and other regulators to consider how to best protect against manipulation and market abuse that may result from trading in naked credit default swaps.

Please explain oil prices and the CFTC's regulatory response in 2008

12. What is your explanation for why oil prices increased from about \$90 per barrel in December 2007 to about \$150 per barrel in July 2008, to fall to less than \$40 today? To what extent was speculation by large banks and index investors in swaps or futures responsible for a portion of the run up?

I believe that rapid growth in commodity index funds was a contributing factor to a bubble in commodities prices that peaked in mid-2008. The expanding number of hedge funds and other investors who were increasing asset allocations to commodities within their portfolios also put upward pressure on prices.

If confirmed by the Senate, I look forward to working with Congress to take a fresh look at the role of speculation in the commodity futures markets.

13. How would you have used the regulatory tools available to the CFTC differently than the CFTC did this year to address the unprecedented spike in oil prices?

Guarding against excessive speculation and market manipulation are two core functions of the CFTC's oversight responsibility. If confirmed by the Senate, I look forward to working with Congress and my fellow Commissioners to increase the CFTC's ability to guard against excessive speculation by increasing transparency around index and other non-commercial investors, reviewing all current hedge exemptions from position limits, and ensuring that position limits are applied consistently across all markets and trading platforms.

I believe that the CFTC could have been more vigilant in guarding against excessive speculation in the commodities futures markets. The CFTC has used no-action letters for important regulatory decisions such as allowing foreign boards of trade direct access to US customers and granting hedge exemptions. These no-action letters have had consequential effects on the Commission's regulatory programs. If confirmed by the Senate, I would undertake a thorough review of the process and standards for which matters come to the Commission and through which no-action letters are issued.

I also believe that the CFTC should promote greater transparency by providing more useful and comprehensive data to the public. For example, the CFTC currently provides weekly "Commitments of Traders" reports (COT's), which show large position interests in certain commodities subject to CFTC oversight. These published reports are segmented into "commercial" and "non-commercial" positions and in some cases, nearly 90% of reported open interests are held by non-commercial traders. I believe we could promote greater transparency and market integrity by providing a further breakdown of non-commercial open interests. If confirmed by the Senate, I will work with the CFTC staff to use the tools at our disposal to protect consumers, investors, and farmers by promoting transparency through more sophisticated data collection and dissemination.

The Commodities Futures Modernization Act of 2000

14. Do you agree that it was prudent to provide “legal certainty” as part of the CFMA to exempt swaps from CFTC regulation?

We have learned a great deal since that time. Capital markets have been transformed and we have witnessed the harsh aftermath of Wall Street’s excesses. I firmly believe that the American public and our economy benefit from strong, intelligent regulation. To be effective, though, regulations must adapt and stay abreast of developing technologies and new products. We must move swiftly now to apply the hard lessons we have learned. We must better protect investors, consumers, and farmers by reforming our regulatory system and enacting far-reaching rules that promote transparency, accountability, fairness, and safety and ensure a crisis of this severity does not happen again.

I believe we must enact a broad regulatory regime for the over-the-counter derivatives market. If confirmed by the Senate, I look forward to working with Congress to bring all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establish a statutory and regulatory framework for derivatives dealers, formulate appropriate oversight for bilateral customized derivatives, and consider further additional regulation for credit default swaps.

Regarding the 'legal certainty' of over the counter derivatives, this issue had been discussed since the establishment of the CFTC in 1974. Since that time, bilateral over-the-counter derivatives entered into between institutional counterparties had not been regulated by the CFTC. This was based upon a combination of the statutory language of the Commodities Exchange Act setting up the CFTC, subsequent Congressional actions, CFTC interpretations and policy statements, case law, and regulatory practice. For instance, in 1974, Congress incorporated the 'Treasury Amendment,' which exempted from CFTC regulation transactions in foreign currencies, government securities, mortgage securities, and certain other debt instruments. Later, in 1989 the CFTC Swaps Policy Statement was issued, followed in 1992 by the Futures Trading Practices Act and subsequently, in 1993, both the CFTC Swaps Exemption and Forward Contract Exemption were issued. One of the principal goals of the 2000 legislation was to provide further legal certainty under the CEA for the then existing regulatory practice.

15. Would you support a complete repeal of the CFMA?

16. If not, what specific part of the CFMA would you repeal?

Answer to 15 & 16

I believe there are many areas where the Commodities Exchange Act should be amended and improved.

In particular, I believe we must enhance the CFTC's ability to guard against excessive speculation in commodities markets and enact a broad regulatory regime for the over-the-counter derivatives marketplace that promotes transparency, accountability, and safety.

If confirmed by the Senate, I look forward to working with Congress to increase the CFTC's ability to guard against excessive speculation by increasing transparency around index and other non-commercial investors, reviewing all current exemptions from position limits, and ensuring that position limits are applied consistently across all markets and trading platforms.

I also believe that all physical commodities, including agricultural, metals and energy, should have consistent regulation under the Commodities Exchange Act. If confirmed by the Senate, I look forward to working with Congress to achieve this objective.

I believe we must also reform regulation of the over-the-counter derivatives market. If confirmed by the Senate, I look forward to working with Congress to bring all standardized over-the-counter derivatives into mandated centralized clearing and onto exchanges, establish a statutory and regulatory framework for derivatives dealers, formulate appropriate oversight for bilateral customized derivatives, and consider further additional regulation for credit default swaps.

Bringing all standardized over-the-counter derivatives into mandated centralized clearing could ensure the daily valuation of transactions through mark to market accounting, enhance the soundness of the system by requiring the timely posting of collateral, and increase transparency into dealers' total aggregate trading positions by underlying commodities.

Bringing standardized derivatives products onto exchanges would promote transparency, increase market integrity, enhance the price discovery function, and provide additional safeguards for investors.

I believe we must establish a statutory and regulatory framework for derivatives dealers including appropriate capital requirements, business conduct standards, and other rules.

I also believe we need to consider appropriate regulations for customized bilateral derivatives that will allow commercial interests and hedgers to maintain the benefits of these contracts, while assuring the transparency, accountability and safety of the system.

Credit default swaps have a close relationship to corporate bonds and other securities. Credit default swaps were used also by some banks to manage their bank capital requirements and to structure asset securitizations. Given these factors, I believe multi-agency regulatory cooperation will be necessary in working with Congress to design possible new regulations for these products.

17. What part of the economy is better off today because of the CFMA?

We are struggling through a time of unprecedented economic turmoil. The challenges cannot be overstated. I believe that both our financial system and our regulatory structure failed the American people. Many elements contributed to these failures and we have learned a great deal.

I firmly believe that the American public and our economy benefit from strong, intelligent regulation. We must apply the hard lessons we have learned to reform and amend the Commodities Exchange Act to better protect investors, consumers, and farmers by reforming our regulations and enacting far-reaching rules to ensure a crisis of this severity does not happen again.

Do you support strong regulatory authority and closing ALL loopholes? Please answer the following questions yes or no.

18. Eliminating exemptions and exclusions: Eliminate the over the counter market exemptions by requiring all future transactions, including credit default swaps, to not only be subject to clearing, but to be conducted on fully regulated exchanges

I believe that all standardized over-the-counter derivatives, including interest rate, currency, equity, commodities and credit default swaps, should be brought into mandated centralized clearing and onto exchanges. I also believe we need to consider appropriate regulations for customized bilateral derivatives that will allow commercial interests and hedgers to maintain the benefits of these contracts, while assuring the transparency, accountability and safety of the system.

Furthermore, I believe that all physical commodities, including agricultural, metals and energy, should have consistent regulation under the Commodities Exchange Act. If confirmed by the Senate, I look forward to working with Congress to achieve these objectives.

19. London Loophole: Require all Foreign Boards of Trade that solicit or accept more than a certain level of the business volume from the U.S. to register as fully regulated domestic exchanges and thus be ineligible for “no action” letters?

I support the CFTC’s 2008 actions to close the “London Loophole” and ensure that foreign futures exchanges with permanent trading terminals in the U.S. comply with the position limitations applied to U.S. exchanges. Furthermore, I believe any foreign futures exchanges that have terminals in the United States to which our investors have access and whose contracts are based on the same underlying commodities should have consistent regulation applied, including position limits. If confirmed by the Senate, I look forward to working with Congress to codify the CFTC’s authority to promulgate regulations

regarding look-alike contracts trading on foreign futures exchanges that affect U.S. investors.

20. *Enron Loophole*: Eliminate Exempt Commercial Markets as an eligible registration class and require existing Exempt Commercial Markets to register as fully regulated exchanges like a Designated Contract Market or a Designated Transaction Execution Facility?

I believe that the “Enron Loophole” should be closed and that uniform standards must be applied to contracts for physical commodities that have the same practical pricing effects, as called for in the 2008 Farm Bill. As I have stated previously, I believe that all physical commodities, including agricultural, metals and energy, should have consistent regulation under the Commodities Exchange Act.

21. *Aggregate Speculation Limits*: Set aggregate speculative position limits on energy and agriculture futures across all contract markets at the control or ownership level?

I believe the CFTC should examine ways to set aggregate speculative position limits on energy and agriculture futures across all contract markets at the control or ownership level.

22. *Manipulation Standard*: Strengthen the Commission’s anti-manipulation authority from a “specific intent” burden to a “recklessness” burden bringing the CFTC more in line with the SEC, Federal Energy Regulatory commission (FERC), and the Federal Trade Commission (FTC)?

Currently, because of recent grants of anti-manipulation authority by Congress to the FERC and FTC based upon SEC case law, there is the possibility that the same set of actions in a market could be subject to different legal standards for manipulation depending upon the agency bringing the case.

If confirmed by the Senate, I look forward to working with Congress and other regulators to consider how to best utilize and interpret the CFTC’s anti-manipulation authority to consistently protect consumers and enhance market integrity.

Increased Resources for the Commission

23. *User-Fee Model*: Adopt a futures transaction-fee model, that FERC uses and that the SEC has used since its inception, to increase available resources to the CFTC?

I believe the CFTC is significantly underfunded to simply meet its current mandates. The CFTC also lacks the necessary technology to monitor today's markets effectively. Likewise, I am concerned that the CFTC has not directed enough resources towards developing a robust staff of independent economists, whose work is essential to the Commission and Congress.

Today, the staff numbers approximately 490, a decline of nearly 20% from earlier in the decade. Over the same time, exchange trading has grown exponentially, and the issues the CFTC faces have increased in complexity. Contracts traded or cleared on US futures exchanges have gone up nearly six-fold from 2000 to 2008. Thus, the CFTC's current resources do not seem appropriate to respond to the challenges we face or the times in which we live.

If Congress acts to expand the CFTC's mission and authority to better regulate over-the-counter derivatives markets, address excessive speculation, and increase investor protection, significant additional resources will be required.

I believe the critical issue is to find adequate resources to support the important work that lies ahead for this Commission. While I have not made an independent determination about user funding, if confirmed by the Senate, I intend to work with Congress and the Office of Management and Budget to find the most effective ways to secure the resources necessary for the CFTC to function fully.

FERC and FTC anti-manipulation authority – please answer the following question yes or no

24. Congress specifically modeled the FERC's and FTC's anti-manipulation authority to allow the agencies to pursue manipulative activity in the futures markets that impact transactions in the cash markets. On the basis of the CEA's "exclusive jurisdiction" provision, the CFTC has resisted FERC's utilization of this authority when pursuing manipulative activity which originated in the futures markets and impacted their jurisdictional cash markets, and has strongly opposed the FTC's rulemaking that would allow it to bring actions which span the physical and financial markets. Will you support dropping this opposition to the FERC's authority in court, and work cooperatively with both the FERC and FTC on allowing them to exercise their authorities to pursue manipulative conduct which spans the physical and financial markets? If not, why not?

If confirmed by the Senate, I would make it a high priority as Chairman to ensure the CFTC works with all other agencies effectively to prevent manipulation, protect investors, and enhance integrity in the physical and financial markets. We must ensure that we use the fullest grants of authority to pursue a robust enforcement agenda. More specifically, if confirmed by the Senate, I would meet with the Chairman of the FERC and of the FTC to find the most effective way to work together in furtherance of the public interest.

Sharing Answers

25. May I share your answers with interested colleagues?

I welcome your sharing these answers with interested colleagues and look forward to making myself available for meetings for follow up discussions.