

UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

CFTC-SEC STAFF ROUNDTABLE  
ON CLEARING OF CREDIT DEFAULT SWAPS

Washington, D.C.

Friday, October 22, 2010

1 PARTICIPANTS:

2 CFTC:

3 ANANDA RADHAKRISHNAN

4 STEVEN GRESKA

5 SARAH JOSEPHSON

6 SEC:

7 JOHN RAMSAY

8 JEFF MOONEY

9 PETER CURLEY

10 Speakers:

11 TOM BENISON  
J.P. Morgan

12 MICHAEL BODSON  
13 DTCC

14 JAMIE CAWLEY  
Javelin Capital Markets

15 ATHANASSIOS DIPLAS  
16 Deutsche Bank

17 CHRISTOPHER EDMONDS  
ICE Trust

18 JEFF GOOCH  
19 MarkitSERV

20 MATTHIAS GRAULICH  
Eurex

21 GEORGE HARRINGTON  
22 Bloomberg

1 PARTICIPANTS (CONT'D):

2 STAN IVANOV  
ICE Trust

3 KRISTIN JOHNSON  
4 Seton Hall Law School

5 LYNN MARTIN  
NYSE Liffe

6 CRAIG PIRRONG  
7 University of Houston

8 KIM TAYLOR  
CME

9 WALLY TURBEVILLE  
10 Better Markets

11

12 \* \* \* \* \*

13

14

15

16

17

18

19

20

21

22

## 1 P R O C E E D I N G S

2 (8:50 a.m.)

3 MR. RADHAKRISHNAN: Good morning. My  
4 name is Ananda Radhakrishnan. I'm with the CFTC,  
5 and welcome to the joint SEC-CFTC staff roundtable  
6 discussion on credit default swaps. We have a  
7 distinguished panel of participants today and I  
8 appreciate their willingness to come here and  
9 answer questions from staff. The roundtable will  
10 take from 9 o'clock to 12 o'clock. There is  
11 another roundtable which starts on 1 o'clock on a  
12 different subject.

13 The objective of this roundtable is to  
14 get what I would consider to be a fulsome  
15 discussion on credit default swaps, the risk  
16 management aspects of credit default swaps,  
17 specifically the most appropriate way of margining  
18 credit default swaps when they are cleared by a  
19 clearing organization. And as you know, the  
20 Dodd-Frank Act divided the world of credit default  
21 swaps between the CFTC and the SEC. The CFTC has  
22 those instruments for which the underlying is a

1 broad base index and the SEC has jurisdiction over  
2 those instruments for which the underlying is a  
3 narrow base index and single credit default swaps.

4           So I hope that in the discussion we will  
5 get recommendations on how credit default swaps  
6 should be margined in the clearinghouse. And then  
7 secondarily with respect to those instruments that  
8 are not margined -- I beg your pardon -- that are  
9 not cleared, how the CFTC and SEC should go about  
10 setting margin requirements on dealers and major  
11 swap participants, both on the security side and  
12 the CFTC side. And what sort of considerations we  
13 should take into account with respect to setting  
14 capital requirements on dealers and MSPs on our  
15 side and the SEC side.

16           And then finally, I hope that we can  
17 have a discussion on whether there should be any  
18 special considerations for the business conduct  
19 standards that we've been charged with writing for  
20 swaps dealers and MSPs both on the CFTC side and  
21 the SEC side.

22           With that I'm going to turn over to John

1 Ramsay, my colleague from the SEC, for his opening  
2 remarks. Thank you.

3 MR. RAMSAY: Thanks, Ananda. And I  
4 don't have too much to add. Before I forget to do  
5 it though I should mention that if I accidentally  
6 express any views, they are my own and not those  
7 of the Commission or any of my colleagues on the  
8 staff. And I just want to say that we're very  
9 grateful to all of our distinguished guests who  
10 have chosen to give their time to come here to  
11 discuss some very complicated issues, things that  
12 we at the SEC and our colleagues of the CFTC are  
13 being asked to address in quite a short time  
14 period. This is just one in a series of events,  
15 roundtables, ongoing discussions happening all the  
16 time between the staff of our two agencies and  
17 we're very -- we're grateful for the very  
18 productive, helpful dialogue that we've had. And  
19 I'm using that expression that misery loves  
20 company and we need all the company we can get.

21 So, anyway, I will I guess start it off  
22 there. Do you want to do introductions, Ananda?

1 MR. RADHAKRISHNAN: Sure.

2 MR. RAMSAY: All right. Go ahead.

3 MR. RADHAKRISHNAN: So let me just have  
4 CFTC staff introduce themselves. We have two at  
5 the table. One is not here right now but Steve.

6 MR. GRESKA: Steve Greska, and I'm with  
7 the risk surveillance section in Chicago in our  
8 Chicago office. And joining us later will be  
9 Sarah Josephson, who will -- heads up our new OTC  
10 division within DCIO.

11 MR. RADHAKRISHNAN: And then just to  
12 make one point, I'll echo what John said, any --  
13 if we offer any opinions it's that of the staff  
14 and it should not be construed as that of the  
15 Commission as a whole or of any individual  
16 commissioner.

17 A couple of housekeeping -- if you would  
18 like to talk you've got to press this button here  
19 so the red light comes on and then make your  
20 remarks. So, and this is Sarah Josephson, also  
21 with DCIO. So I'm going to turn it over to my SEC  
22 colleagues. Thank you.

1           MR. RAMSAY: I have here with SEC staff  
2 Jeff Mooney, assistant director, division of  
3 trading and markets. Peter Curley is an attorney  
4 fellow also in our division of trading and  
5 markets.

6           MR. RADHAKRISHNAN: So maybe we could  
7 have the participants introduce themselves and  
8 then we can start with the questioning. Thank  
9 you.

10          MR. DIPLAS: Yes, hi. I'm Athanassios  
11 Diplas from Deutsche Bank. I'm also representing  
12 ISDA as a co- chair of the Credit Steering  
13 Committee.

14          MS. TAYLOR: Kim Taylor, CME Clearing.

15          MR. EDMONDS: Chris Edmonds, president  
16 of ICE Trust.

17          MR. IVANOV: Stan Ivanov, chief risk  
18 office for ICE Trust.

19          MR. GRAULICH: Matthias Graulich, Eurex.

20          MR. BODSON: Mike Bodson, COO, DTCC.

21          MS. JOHNSON: Kristin Johnson, Seton  
22 Hall Law School.

1                   MR. PIRRONG: Craig Pirrong, University  
2 of Houston.

3                   MR. TURBEVILLE: Wally Turbeville,  
4 Better Markets, a non-profit organization.

5                   MR. GOOCH: Jeff Gooch, CO of  
6 MarkitSERV.

7                   MR. CAWLEY: Jamie Cawley from Javelin  
8 Capital Markets, also representing the Swaps  
9 Derivatives Market Association.

10                  MS. MARTIN: Lynn Martin, chief  
11 operating officer, NYSE Liffe US.

12                  MR. RADHAKRISHNAN: Thank you. And  
13 since our colleagues from the SEC traveled all the  
14 way from the SEC I'm going to let them start off  
15 with the questioning.

16                  MR. RAMSAY: Thanks so much. I thought  
17 perhaps we might start off with a little bit of a  
18 recap of the evolution of the CDS market in recent  
19 years which has been a lot about the increasing  
20 standardization of those products. ISDA has been  
21 heavily involved in that effort and Athanassios  
22 has agreed to give us a short history lesson and

1 remind us how we got to where we are today and  
2 maybe say a little bit more to about current  
3 efforts to further the process of standardizing  
4 these instruments.

5 MR. DIPLAS: Great. Thanks a lot, John.  
6 As you just said, the effort on standardization  
7 started a few years ago. I would say probably  
8 since 2006 we have started looking at ways to  
9 improve the instruments and make them more  
10 suitable for clearing eventually. The effort  
11 obviously intensified when we started dealing with  
12 credit events. We had to come up with a credit  
13 event auction process that started back in  
14 2006-2007 and has evolved since then. Obviously,  
15 the auction portion was fundamental in order to  
16 ensure that transactions can be settled centrally  
17 and not kind of bilaterally as used to be the case  
18 before. In order also to move towards a clearer  
19 state we also had to ensure that any decisions  
20 market-wide actually get done at the central level  
21 and not bilaterally. And the CCP has always to be  
22 sure that it is going to be a flat risk at the end

1 of the day.

2 So that led to the -- to an effort that  
3 we -- and the protocol that we call the big bang,  
4 which basically tried to create a determination  
5 committee and also introduce other aspects of  
6 standardization. And that was followed by the  
7 small bang that actually took those changes and  
8 expanded them also to include other credit events  
9 such as restructuring.

10 One of the most, very important also  
11 changes in the conduct was the introduction,  
12 especially for the North American conducts but  
13 also for Europe with what we call SNAC, the  
14 Standard North American Conduct which actually  
15 standardized the coupons and we had already  
16 standardized maturities and that basically made  
17 the conduct a little bit more widget-like and that  
18 was obviously easier from a risk management  
19 perspective for the CCP to manage these conducts  
20 in the event of default.

21 Again, a lot of the effort, if you look  
22 at the standardization, people a lot of times have

1 looked at the standardization of economic terms,  
2 such as coupons. The reality is that the most  
3 important standardization, the thing that we have  
4 achieved and we'll actually keep striving to  
5 achieve with respect to legal standardization and  
6 process standardization. And that's why, for  
7 example, the big bang was extremely instrumental.  
8 The determination committee is fundamental.  
9 Without the ability to make those decisions  
10 centrally and have them be binding for all  
11 participants, the framework, if we tried to put it  
12 in place right now, would not have worked.

13           So this is obviously -- has already  
14 taken place. And as we progress, right now we  
15 will keep looking at new areas, to mention  
16 actually more complicated to kind of move the same  
17 way. So in that respect clearly there's not  
18 actually much more to be done in that respect for  
19 indices or single names but then we're looking to  
20 do more work in (inaudible), et cetera. But if  
21 you look right now at credit CDS and compare it to  
22 other asset classes, I would say that actually we

1 have achieved probably the highest degree of  
2 standardization in the asset class.

3 At the same time the asset class itself  
4 was more conducive to standardization as opposed  
5 to other asset classes such as interstate swaps  
6 because the needs of the participants were  
7 different and actually were able to tolerate more  
8 standardization. If you look at interstate swaps,  
9 for example because of hedge accounting, etcetera,  
10 they have to -- they require a specific date if  
11 they have a bond they need to hedge. These needs  
12 are not the same on the credit side and that's why  
13 we're able actually to achieve as much as we have  
14 achieved.

15 MR. RADHAKRISHNAN: Thanks. Sorry,  
16 before I go further, a couple of other technology  
17 points. It may be obvious to you but this meeting  
18 is being recorded so you should know that. And  
19 also, please refrain from putting any BlackBerrys  
20 or cell phones on the table as they are known to  
21 cause audio interference.

22 I'd like to talk about clearing. And

1 I'm going to ask this question first of the  
2 clearinghouses that are here but then, you know,  
3 others can please chime in. What product  
4 characteristics are prerequisites for the clearing  
5 of credit default swaps? And in particular,  
6 please discuss the degree of standardization that  
7 is essential -- that you believe is essential for  
8 clearing, the availability of reliable price  
9 information, and what elements of liquidity --  
10 market liquidity -- do you look for before you  
11 decide to clear products. So maybe we can start  
12 with Kim. Thank you.

13 MS. TAYLOR: Thanks, Ananda. The types  
14 of characteristics that we look for in being able  
15 to clear a product include the standardization of  
16 the terms, and by that we mean that there is  
17 complete clarity among market participants of what  
18 is being traded. So the standardization of the  
19 contracts is important. I think the availability  
20 of pricing information sufficient to allow us to  
21 provide a good representation of market price on  
22 any given day for the market to market process and

1 also the ability to model the risk characteristics  
2 of the character on a looking forward basis so  
3 that we can appropriately assess the risk and  
4 appropriately calculate the margin requirement.  
5 Those are very important characteristics.

6 As far as the liquidity in the market,  
7 we do look at the availability of transparent  
8 pricing in the market. We do look at the market  
9 composition. So a market with a broader set of  
10 participants is preferable to a market with a  
11 smaller set of participants. Although please keep  
12 in mind that with setting up a risk management  
13 regime there are ways to compensate for certain  
14 deficiencies up to a certain extent. So if  
15 there's a less liquid marketplace you can  
16 compensate for that to some extent with a higher  
17 margin or with a different type of guaranty fund  
18 or a different type of default management process.  
19 So also we're looking for products that we would  
20 be able to have comfort that we would be able to  
21 access the marketplace in a crisis situation  
22 should we need to liquidate the portfolio.

1           MR. EDMONDS: I don't know that it would  
2 be much different than what Kim went through at a  
3 macro level. Everything we've done so far has  
4 been on a risk base model. And I'm going to turn  
5 it over to Stan and let him walk through more of  
6 the specific characteristics of both the sectors  
7 as well as the index.

8           MR. IVANOV: In general, we developed a  
9 very specific rules and practices for selection of  
10 single names and indices that would be cleared.  
11 We looked specifically at the open interest in  
12 terms of recorded transactions at the trade  
13 warehouse. We also look at the number of  
14 counterparties that would participate. We have a  
15 minimum number of counterparties that would be  
16 involved in keeping positions in those instruments  
17 that we would be interested in clearing. There is  
18 a minimum number of such participants. We have  
19 developed a very strong and very robust end of day  
20 price discovery process which is very unique in  
21 terms of receiving prices and being able to market  
22 to market rather than market to model or market to

1 myth. The same people typically we would refer to  
2 in terms of CDS market believed in our pricing.

3           On the other hand, we've been very  
4 selective as Kim and Chris mentioned. The risk  
5 characteristics in terms of selection of specific  
6 names that belong to given sectors and how these  
7 single names would fit the initial set of  
8 instruments that we started clearing in terms of  
9 indices because the initial launch by ICE Trust  
10 was based on index clearing services and then we  
11 expanded to single names, carefully adding more  
12 and more names in every single sector so we could  
13 achieve a specific number of single names that  
14 could be used for potential hedging and decreased  
15 cost upon liquidation if a clearing participant  
16 defaults, namely providing portfolio benefits in  
17 the sense of index versus single name liquidation  
18 or unwinding.

19           So there are a little bit more technical  
20 aspects in the selection process but overall we  
21 look at the index, the risk characteristics, their  
22 ability again to price these instruments where our

1 selection criteria involve a very thorough back  
2 testing and stress testing, namely given the new  
3 instruments that we intend to clear and those that  
4 are already in the clearing services, how the new  
5 instruments will fit the overall risk profile upon  
6 stress testing, back testing, just to see if there  
7 is any specific type of risk, correlation risk or  
8 extreme risk that could lead to worsening to the  
9 overall risk profiles that the clearinghouse will  
10 keep in terms of their members.

11 MR. RADHAKRISHNAN: Matthias.

12 MR. GRAULICH: Well, I think if you look  
13 from a, well, risk management margining  
14 perspective, I think a clearinghouse has or faces  
15 the same problems as if the business stays  
16 bilateral between two counterparties. So  
17 basically we look at it from a back end. So what  
18 happens in a liquidation scenario? And given the  
19 characteristics of the CDS market it's, well,  
20 there are, for example, all the series which don't  
21 have liquidities or you face always the problem  
22 that in a default scenario you at the

1 clearinghouse have to get rid of the positions.  
2 And now I believe that generally everything could  
3 be cleared but it depends on a commitment from the  
4 market participants and the clearinghouses to act  
5 in such a situation of a liquidation and the  
6 default to provide prices and to, well, be willing  
7 and able to buy a certain portfolio or bid for a  
8 portfolio. So that would mean you need to go for  
9 an auction process. There needs to be some  
10 mandatory element of this auction process attached  
11 to it to really protect the overall economic  
12 framework.

13 MR. RADHAKRISHNAN: Thank you. Now, we  
14 have two academics here who have given a lot of  
15 thought to this subject and I'd like to invite  
16 them. Kristin Johnson.

17 MS. JOHNSON: Thank you. I'm very  
18 enthusiastic of the inclusion of the academics in  
19 this conversation. My colleague, Craig Pirrong  
20 and other colleagues in the Academy have been  
21 writing about the necessity of regulation in the  
22 over-the-counter derivatives market for decades,

1 and we are enthusiastic about the opportunity to  
2 be invited into the conversation, largely because  
3 as Matthias mentions, there are significant  
4 continuing concerns subsequent to the adoption of  
5 the Dodd-Frank Act with respect to liquidation  
6 scenarios, particularly when execution facilities  
7 or derivatives clearing organizations might be  
8 allowed in certain instances to be the recipient  
9 of federal funds in the event that there is a  
10 default of the clearinghouse.

11 We know that our colleagues at the  
12 clearinghouses have regularly introduced  
13 significant reforms, risk management, and pricing  
14 discovery reforms, that have aided in the  
15 stability of financial markets. And for that we  
16 applaud them. But we are thoughtful about the  
17 responsibility and expectations of accountability  
18 that the Dodd-Frank Act introduces for regulators.

19 So on that note there are some issues,  
20 at least two that I would raise, as concerns in  
21 the development of regulation for the  
22 clearinghouses. And the first is that the pricing

1 models and the risk management models are still  
2 continuing to be proprietary models, in which case  
3 we are hoping that in every instance each of the  
4 independent businesses is effectively able to  
5 model and manage risk effectively. I think  
6 historically there has not been, as there will be,  
7 such a level of necessity for regulators to be  
8 familiar with and have the capacity to engage  
9 rigorously in a robust debate about assumptions --  
10 the underlying assumptions in these models.

11 MR. PIRRONG: I second Kristin's  
12 appreciation for being -- having academics  
13 included in the debate. It is refreshing to see  
14 such an open debate on these sorts of issues. I  
15 just have a couple of comments, and one comment  
16 generally is who should be making the decision  
17 regarding what to clear and how to margin it. And  
18 I think it's very important that the decision be  
19 left with the folks that have the information and  
20 have the incentive. And, yeah, that's one concern  
21 that I have going forward in terms of who has the  
22 ability to decide. And I think that the kinds of

1 criteria that Kim and Chris and Matthias mention  
2 here, you know, are crucial in terms of having a  
3 good understanding of pricing in the market,  
4 having products that are sufficiently liquid.  
5 It's not a matter of contractual standardization  
6 per se that's important. That's a necessary  
7 condition but not a sufficient condition to make  
8 something clearable. Instead, it's having the  
9 information on pricing and risk that is crucial.  
10 And having the people that are ultimately at the  
11 end of the day going to be the residual bearers of  
12 that risk have the ultimate authority over whether  
13 that's a risk that they're comfortable in bearing  
14 or not.

15 In terms of margining issues generally,  
16 I just think one thing that's very important to  
17 keep in mind with all products, but particularly  
18 with CDS, is frequently there's an incentive or a  
19 tendency to think of things on a product by  
20 product basis or a name by name basis. But when  
21 you're talking about CDS, you know, particularly  
22 various sorts of correlation risks that are very

1 hard to understand and very hard to get a good  
2 grip on are extremely important and of first order  
3 importance in these sorts of markets. And that's  
4 another sort of issue that I think regulators have  
5 to be particularly aware of going forward.

6 MR. RAMSAY: Ananda, before we get waist  
7 deep in a lot of the policy issues I just wanted  
8 to ask anybody who has some thoughts on it, in  
9 terms of looking at the evolution of the market  
10 and development as between index products versus  
11 single name CDS or narrow based index, how people  
12 see that progression developing. Will the  
13 prospect of clearing change that? Obviously, from  
14 the SEC standpoint we have a particular interest  
15 in products that can be either used as proxies or  
16 in tandem with an underlying equity. We have a  
17 concern with the whole area, of course, but it  
18 might be interesting to get people's perspective  
19 on how they see the migration of this particular  
20 part of the market developing in terms of  
21 breakdown of product types.

22 MR. DIPLAS: Yeah. I mean, if you look

1 at the progression of the introduction of products  
2 in the clearing, obviously we have started with  
3 indices because they're actually simpler products.  
4 They have less volatility and therefore that was  
5 the natural product to actually experiment with.  
6 I would say that that has gone well and that's why  
7 you see the success. And the fact is among  
8 eligible participants we have cleared north of 95,  
9 96 percent of most of these liquid indices. So  
10 that was where we started.

11 Obviously, the next step was to  
12 introduce the single names which carry with them  
13 more risk and that's why the risk models had to be  
14 adjusted. I think most seem to be started with  
15 kind of regular, you know, models they have used  
16 already in futures when they dealt with indices  
17 but obviously when we went to single names the  
18 models had to adjust significantly.

19 From a clearing participants perspective  
20 we have an interest to maintain balanced books.  
21 So to the extent of actually we trade in both  
22 indices and single names, we have an incentive to

1 actually, for example, to introduce the next  
2 components into clearing as quickly as possible so  
3 that actually our exposure in and out of clearing  
4 is balanced. So that has been kind of one of the  
5 prioritization schemes with respect to the  
6 introduction of single names to try to look at  
7 index constituent components.

8           So and obviously we also start to kind  
9 of, you know, with more low volatility names among  
10 those. And that's how we're pushing the envelope  
11 right now. Obviously, some of the other names  
12 that we need to introduce but it will become more  
13 complex is when we introduce financials. That's  
14 when we start dealing with, and Craig touched on  
15 that, the correlation issues basically. How is it  
16 basically, you know, Deutsche Bank, Morgan  
17 Stanley, CDS, etcetera. So all of those obviously  
18 are more sensitive and that's where a lot more  
19 work needs to take place.

20           Just to finish quickly on the comments  
21 that people made earlier, I would also agree with  
22 them. I think all the thoughts expressed I

1 definitely agree with. It's very important to  
2 remember. Unfortunately, people say economics is  
3 a dismal science and CCPs take pessimism to a  
4 whole new level because all we talk about is  
5 default and it's all about default management. So  
6 all it is, when one of us goes under what happens?  
7 Do we have the ability to unwind that portfolio  
8 successfully? Step number one is to ensure that  
9 we have already priced it properly. Step number  
10 two is that we have estimated the gap properly.  
11 The gap risk properly.

12           So there is also the second part which  
13 is the mutualization element. As we look into  
14 tradition in naming that we're going to ensure  
15 that actually that name, for example, was started  
16 by multiple participants. We don't want to be in  
17 a situation for argument's sake that participant A  
18 and participant B are trading a name, participant  
19 A defaults, and there's only one person in the  
20 whole CCP that knows how to price that instrument.  
21 So that is an example of something that would be  
22 inappropriate to clear.

1           The second thing is we have to make a  
2   guess and that's not a black and white decision  
3   obviously -- I'm going through this every day  
4   obviously -- is to estimate what is going to be  
5   the liquidity of that given name for the life of  
6   the product. The liquidity has changed  
7   significantly from the beginning when the products  
8   are on their own to when it is 1-1/4 here and you  
9   never see a trade.

10           So these are kind of -- I know we're  
11   going to get into more details later but these are  
12   the kind of issues that basically we have to  
13   consider as we look into expanding the envelope.

14           MR. EDMONDS: Ananda, just to quantify  
15   Athanasios point about expanding the envelope,  
16   you know, right now we clear 89 single names here  
17   in the U.S. and a little over 100 in Europe. I  
18   would estimate that as confidence gains as some of  
19   the uncertainty around what the rules will be and  
20   how these products work together, how portfolio  
21   margin is developed from a regulatory status, you  
22   can see that list grow. We'll use a round number;

1 it won't be correct. Somewhere around 300. You  
2 know, maybe it's 400, maybe it's 250, whatever,  
3 over time, but that will be something that we grow  
4 into as we get through that. But that is  
5 predicated upon clear understandings of the rules  
6 and the expectations from a regulator status.

7 MR. BODSON: If I can draw some  
8 analogies from the cash side of the marketplace.  
9 The point about what's liquid today becomes very  
10 liquid tomorrow we saw very closely when we did  
11 the Lehman liquidation where we had about a 500  
12 billion gross book. The positions -- the treasury  
13 positions, equity positions, were all hedged out  
14 and started being liquidated fairly immediately.  
15 What was difficult were all the corporate bonds.  
16 Trying to cover a short TBA bond is not a simple  
17 process but with the margin that we had from the  
18 liquid positions we were safe in terms of loss  
19 protection. But they're very much dependent upon  
20 the percentage of liquid positions versus illiquid  
21 positions. And as these products come on and go  
22 through this phasing that will be an important

1 consideration in terms of a high concentration of  
2 illiquid positions obviously could be very  
3 difficult to deal with.

4 In terms of there was a comment about  
5 model reviews, we are working with the New York  
6 Stock Exchange Life on NYPC. And I have to say  
7 that the thoroughness of the model reviews by the  
8 regulators is unsurpassed. We have gone through  
9 hoops and multiple iterations of reviews and so on  
10 and so forth. So while there may be different  
11 approaches as you said, it should remain with  
12 those who have the interest in the results. The  
13 regulatory oversight is rigorous and thorough and  
14 hopefully is consistent across the marketplace.

15 And lastly, I just want to address there  
16 was a point that was made about use of federal  
17 funds. I'm not sure if you were alluding to a  
18 bailout of a CCP or liquidity which is an issue  
19 that goes often confused. We've talked about  
20 access to the fed window in order to get liquidity  
21 to keep the market flowing. That's not a bailout  
22 obviously. That's a loan, usually a

1 collateralized loan. So I just want to make sure  
2 that those two are two very separate issues.

3 MS. JOHNSON: True.

4 MR. RADHAKRISHNAN: Thank you. If I  
5 could pick up on things that Athanassios said,  
6 which is the ability to give prices -- quote  
7 prices and the ability to participate in default  
8 management. How do we as regulators make sure  
9 that those two items or those two considerations  
10 don't become barriers to entry for people who want  
11 to participate in clearinghouse? So perhaps those  
12 who haven't had a chance to speak would comment on  
13 that.

14 MR. CAWLEY: Hi, this is Jamie from  
15 Javelin Capital Markets. It's a good question.

16 I would say one thing is that the market  
17 is dynamic and as we move through time the  
18 liquidity certainly changes on a micro context but  
19 also on a macro context. And what I mean by that  
20 is certainly the impact of several SEFs, swap  
21 execution facilities, is going to help drive  
22 transparency and pricing of individual instruments

1 and interest rate swaps, and also certainly in  
2 CDS. You know, currently today the liquidity is  
3 certainly clustered around a five-year swap point.  
4 Over time we would expect that that would change  
5 as transparency, you know, comes to the market  
6 with life screen trading, certainly as it goes  
7 down into the one year context and further out  
8 into 10 and even 20 and 30 year. So what I would  
9 say is that it becomes almost, you know,  
10 self-fulfilling. You know, the more things that  
11 trade or are eligible to be cleared in a  
12 clearinghouse is also assisted by the multiple  
13 SEFs that then pop up and start driving and  
14 creating transparency in the marketplace.

15 One sidebar is it's good to note that  
16 there's competition between clearinghouses. So  
17 there is an incentive, an economic incentive, for  
18 people to bring new products to market or to  
19 accept more individual names into clearing. That  
20 said, it should be balanced against sort of a race  
21 to the bottom such that -- and that's where Ananda  
22 you come in -- to ensure that that balance is

1 carefully tendered.

2 MR. RADHAKRISHNAN: Thank you. I think  
3 Jeff will have something to say about the race to  
4 the bottom.

5 MR. GOOCH: We're against the race to  
6 the bottom.

7 (Laughter)

8 SPEAKER: Is that a personal or a  
9 Commission statement? (Laughter)

10 I think it's actually a very interesting  
11 question about price liquidity and default  
12 management Matthias raised and how many products  
13 you actually intend to clear because I think the  
14 CDS market is in aggregate very large but each  
15 individual name actually very small. If you look  
16 at the top thousand single names they traded less  
17 than four times a day on average. There's  
18 probably on 30, 40 names trading even 10 times a  
19 day. As Jamie said, you know, there's probably a  
20 number of materials. It's perhaps 30 percent of  
21 that to the five-year point but they're spread  
22 over a number of maturities.

1           So you're trying to clear what is the  
2 individual name that will fare the liquid market.  
3 And I think where you get a lot of debate across  
4 the industry is how do you defend against that.  
5 There's two solutions. One is to only clear the  
6 very liquid products, which can, you know, be easy  
7 access to pricing. You can run daily cycles,  
8 etcetera. You can be pretty sure there's enough  
9 liquidity to move the names out.

10           Or as you start moving further down that  
11 curve which, you know, seems to be the direction  
12 we're going, putting less liquid product into  
13 clearinghouses, I think as Kim mentioned, there's  
14 ways of dealing with that. That starts to force  
15 you to put commitments on individual clearinghouse  
16 members to take part in daily auctions for  
17 pricing; commit to, you know, take part in a  
18 default situation; to take part in auction to help  
19 move some of those less liquid names that the  
20 clearinghouse could never realistically trade out  
21 for themselves. And as you do that, that puts the  
22 onus on the clearing members to be higher and

1 higher and higher, which tends to concentrate you  
2 on the more professional users, the larger users,  
3 being the only people who can realistically make  
4 those commitments. And, you know, there's certain  
5 parts of the industry that sort of complain about  
6 that in terms of excluding some of the smaller and  
7 midsize players. But I think after the inevitable  
8 consequences, the choices everyone takes about how  
9 much business is going to be cleared, you know, if  
10 you clear very liquid investment rate indices you  
11 can probably run a very different set of  
12 membership requirements and obligations than if  
13 you're trying to, you know, include the 300 most  
14 liquid single names, that's going to be much  
15 tougher.

16           And I think that's why it gets to be a  
17 very emotive subject because depending on how much  
18 you try to put on, you have to deal with the lack  
19 of liquidity in other means and that in itself  
20 creates barriers. So I think it tends to get a  
21 very emotive subject.

22           MR. HARRINGTON: George Harrington from

1 Bloomberg.

2 I think barriers to entry are really a  
3 key subject in the clearing -- in the clearing  
4 debate as far as, you know, what are the barriers?  
5 And obviously, you know, being in a clearinghouse  
6 obviously has its own challenges as far as the  
7 default management rules. But also for the, you  
8 know, for all the participants who are going to be  
9 involved, whether it be a SEF, whether it be an  
10 SDR or a clearinghouse or a real-time reporting  
11 facility, whatever it may be, all these products,  
12 especially in the CDS space, you know, I have a  
13 lot of standardized terms as we've talked about.  
14 But with that there needs to be access to the  
15 usage for the participants of the, you know, the  
16 basic standardized information around those  
17 products. But then also open access to the, you  
18 know, to the clearing facilities.

19 And when we say open access, obviously I  
20 think the race to the bottom is a good point. You  
21 know, I think it's almost technologically  
22 impossible for everyone to say, well, I'll be

1 fully interconnected to everyone who comes to the  
2 market in real-time. That being said, for  
3 participants or major participants, I think that  
4 there certainly should be a standard set that open  
5 access, you know, among the providers of  
6 functionality, whether it be clearing, whether it  
7 be execution facility or swap data repository, you  
8 know, there's a lot of utility-like items that  
9 need to be -- that need to be able to accessed at  
10 a fair level.

11 MR. RADHAKRISHNAN: Go ahead. Lynn and  
12 then Wally.

13 MS. MARTIN: Okay, as the lights are  
14 going out. Thank you to the SEC and CFTC for  
15 inviting NYSE Euronext to participate on today's  
16 panel.

17 I just want to touch on a couple of  
18 things that some of my co-panelists have mentioned  
19 today. One around the idea of open architecture,  
20 specifically that there needs to be a common set  
21 of core principles or a common regulatory  
22 framework that governs these things so that we

1 don't have a race to the bottom, so that there  
2 isn't a regulatory arbitrage opportunity  
3 potentially created.

4           But one of the other points that I  
5 wanted to touch on is the migration of products  
6 into central clearing and how in order for an  
7 efficient migration of the products to central  
8 clearing what needs to be considered is the way  
9 the markets trade today and allowing the markets  
10 to continue to trade in that manner. If the goal  
11 is to migrate products into a central clearing  
12 platform then in an efficient manner what should  
13 occur is that markets need to be allowed to trade  
14 as they are today to some extent.

15           Moving to central clearing leads to  
16 additional standardization and that potentially  
17 could make the market models that are adoptive for  
18 certain products today evolve in the future to  
19 more of central order book products. But to force  
20 the products into a central order book mechanism  
21 when they generally don't lend themselves because  
22 of the infrequency of trading or the bespoke

1 nature of the products could potentially affect  
2 the liquidity of those products.

3 MR. RADHAKRISHNAN: Sorry, Wally wanted  
4 to say something.

5 MR. TURBEVILLE: Thanks. Yeah, I think  
6 it would be a good time to -- because there's  
7 several concepts floating around here that need to  
8 sort of be tied together. Craig was talking about  
9 the motive for -- the decision-making process for  
10 including instruments in clearing and it has to do  
11 with this is a law that depends on the  
12 clearinghouses to make decisions to -- for its  
13 success or failure. So what is I believe  
14 critically important is that the clearinghouses  
15 who offer these services do have the motive to  
16 advance the principles behind Dodd-Frank. And in  
17 thinking about that I think it's real important to  
18 think about what the real decision-making process  
19 is about. When we say something is -- doesn't  
20 have the risk construct to qualify for clearing,  
21 what we're really saying is that there's a  
22 decision being made that the residual risk beyond

1 what can be collateralized is somehow  
2 inappropriate for redistribution allocation beyond  
3 the collateral to various members of the  
4 clearinghouse. That's what we're talking about.  
5 So it's a question of reallocation of that excess  
6 risk.

7           And the decision between an instrument  
8 -- if an instrument is going to be entered into  
9 and cleared or uncleared, if it's uncleared it's  
10 in an environment where all the fine attributes of  
11 clearing, like standardization, clearing causes  
12 standardization to occur. Like transparent  
13 management of the risk, margining of the risk in a  
14 proper and timely way. All those things don't get  
15 done.

16           So I think the challenge is not simply  
17 to live with the fact that those kinds of  
18 limitations are on us but I think beyond ways,  
19 beyond just putting up more collateral, beyond  
20 some of the more obvious ways to try to bring as  
21 much product into the clearing environment as  
22 possible and not do a race to the bottom but

1 rather try to imaginatively think of ways that we  
2 can bring as much into the process as possible  
3 without racing to the bottom, without creating  
4 systemic risk.

5 MR. RAMSAY: I was, your statement just  
6 triggered something I was trying to ask generally  
7 which is -- make a statement first of all which is  
8 kind of an obvious one. The statute has put the  
9 regulators in -- sort of in the middle of this  
10 dynamic in terms of figuring out what gets cleared  
11 and how much and how one makes those  
12 determinations. And you know, so one of the  
13 things we're going to be dealing with is trying to  
14 come up with an appropriate framework for making  
15 those kinds of decisions. As a threshold matter,  
16 for example, for determining that if something is  
17 -- can be cleared, if it's approved by  
18 clearinghouse and approved by the regulators,  
19 improved by clearinghouse to trade, that that  
20 product or economic equivalence must then be  
21 cleared.

22 So I guess one question is do we allow

1 for bilateral trading to continue side by side for  
2 at least those class of things that we have  
3 determined commercially can be cleared? And  
4 there's a mechanism for doing it so I'll just  
5 throw that one out as a first.

6 MR. CAWLEY: I would say -- it's Jamie  
7 from Javelin again.

8 I would say that if you allow, and  
9 certainly, you know, there are instances where  
10 bilateral trading should continue, one has to be  
11 very careful that if you allow that there should  
12 still be a significant impetus for the market to  
13 continue to be centrally cleared. So where we  
14 sit, if you look at the credit default market and  
15 North American credit, you see that index which is  
16 essentially three or four products, are 40 percent  
17 to liquidity on any daily basis. They are  
18 comprised of 248 constituent names. Specifically,  
19 we believe that they should all at some point be  
20 cleared, be it 85 names today, bootstrapping 50,  
21 60 names over a successive period over the next  
22 two to three years, such that 248 names at least

1 are traded are clearable.

2           There's about 450 to 500 credits that  
3 trade actively in North America. I think if you  
4 capture the 248 names and index, you're capturing  
5 approximately 60, 70 percent of the daily volume  
6 in the credit default swap market today.

7 Obviously, as you trail out from there, there are  
8 credits that don't trade that frequently. I would  
9 say that one has to consider and be mindful that  
10 volume does not mean or the lack of volume in a  
11 particular trade or a particular name does not  
12 mean that you cannot price it. As any credit  
13 trader will tell you, it trades on a curve. So  
14 whether it be a five year, you know, take a GMAC  
15 curve or Fannie or Freddie, there are thousands of  
16 issues that get priced on a daily basis. And it's  
17 not necessarily mark to myth; these are legitimate  
18 prices where traders put risk of balance sheet at  
19 work every day as they provide liquidity to the  
20 market space.

21           So I would be mindful that over time the  
22 market should drive towards clearing. And to the

1 extent that you allow or there is a necessity for  
2 bilateral trading to occur, you should somehow  
3 handicap it with some type of capital, you know,  
4 the appropriate amount of capital to, as an  
5 incentive let's say, to ensure that there's no  
6 gaming of the system such that names unnecessarily  
7 sit outside the cleared context.

8 MR. DIPLAS: I'd like to take a second  
9 to explain what we have in place in terms of  
10 trying to mark conducts and why we have made those  
11 choices. I'm following up on what Jeff said  
12 earlier. If you look -- even if we had made a  
13 decision to just go with the most liquid  
14 instrument out there which is the only one  
15 investment grade index, that liquid as we know it  
16 could trade a thousand times a day. But in about  
17 six months time when it becomes (inaudible) the  
18 volume will drop by 90 percent. In another six  
19 months, that volume drops to practically zero, to  
20 a few trades a day. Okay? So that is why even if  
21 you start with the most liquid instrument it will  
22 become illiquid eventually. It's the aging

1 process. Unfortunately, we all have to go through  
2 that. (Laughter)

3           So we have to have the confidence,  
4 however, that we mark this thing properly. And  
5 the mechanism that has been introduced is actually  
6 a quite stringent one and onerous perhaps you  
7 might say but it is fundamental. If you look at  
8 the curve, and we go back to single names, when we  
9 talk about the name trading, in name trading ten  
10 times it means there are 40 points on this curve  
11 and there are 10 trades in one of those 40 points.  
12 Five of them are most of the time with the five  
13 year. The other five get distributed among the  
14 rest of the 39 widgets.

15           So what do we do? We will not observe  
16 this. And as James said, we will have to price  
17 some of these things on the curve. So what do we  
18 do? We have put an obligation on the clearing  
19 members to basically give two-way prices which can  
20 be actually executable two-way prices in order to  
21 give the confidence to the clearinghouse that they  
22 know what that market is. Because, remember, even

1 if it trades on a SEF, the five year might trade  
2 but you will not see the two year.

3           So just to give an example, if everybody  
4 says on a given day they mark the two year at 99  
5 and 101, the mid market is 100, and I say I'll  
6 market 199, 201, I'm off clearly, either because  
7 for some malicious reason or because I don't know  
8 what's going on. But what happens is in that  
9 process I get penalized by cross trade. So that's  
10 why I have to basically take that responsibility  
11 to take the trade on. Now, the benefit of that  
12 process is that it introduces honesty and  
13 information into the process and the next day or  
14 so my manager will know that actually I don't know  
15 how to mark these things. So probably he will  
16 tell me to actually go fix it. So that is the  
17 process. It creates a virtual cycle to actually  
18 give that information. So that's what we have put  
19 in place.

20           Now, that as Jeff said, is a very  
21 onerous process. So whoever is participating in  
22 that has to stand up and be subject to that

1 process. And that's why I said that if there's  
2 only two people doing that, clearly that's not  
3 good enough. It's going to fail. We need to have  
4 a minimum mass of people actually trading these  
5 things. And (inaudible) we have looked  
6 (inaudible) I'm looking at the CCPs here who have  
7 wanted to have at least four people that actually  
8 provide prices in that scenario. So that's kind  
9 of a number.

10 But I have to be careful. We have to be  
11 careful. This is not going to go away. SEFs or  
12 no SEFs, it's not going to go away. SEFs will not  
13 create liquidity beyond what clients have to do.  
14 The needs of the clients are what drives the  
15 liquidity. And if you think of clients, I would  
16 say think of them in two ways. There's the people  
17 that actually are the frequent traders that will  
18 trade around the five year. That's why you see so  
19 much of the volume of the five year. They always  
20 want to trade the active conduct. And then there  
21 is the others that basically they're the buy and  
22 hold customers. They will buy -- they hedge a

1 bond and they buy CDS with it. As the bond ages  
2 the CDS ages. So those guys will never trade it.  
3 But we need to price remember everything in the  
4 clearinghouse.

5 So that's the last thing. Keep in mind  
6 these processes have to be strong. And whoever  
7 comes in has to stand up to fulfill that  
8 obligation.

9 MR. BENISON: Just, I fully agree.

10 MR. RADHAKRISHNAN: Let -- Kristin  
11 wanted to say something.

12 MS. JOHNSON: Thanks so much. I want to  
13 go back to the original question that seems to be  
14 on the table in that with respect to what we can  
15 determine based on what the CCPs regularly clear  
16 to be eligible there seems to be a question about  
17 whether regulation mandates whether we interpret  
18 Dodd-Frank and read the congressional statute to  
19 mandate clearing of those instruments. And I  
20 think there's a parallel question within the  
21 eligibility and ineligibility discussion. And let  
22 me explain what I mean by that.

1           It was Lynn who mentioned that there  
2 would need to be consistency as to how we treat --  
3 how the regulation treats the various  
4 clearinghouses and examines them. And there will  
5 be real challenges here because as the CFTC and  
6 the SEC come together to attempt some form of  
7 harmonization. There are historic principles  
8 versus rules- based questions that will arise  
9 here. And so in looking at the question of the  
10 requirement for clearing of what the market has  
11 deemed to be eligible -- eligible names or  
12 eligible indices or other products that clearly  
13 the CCPs are regularly clearing, I won't resolve  
14 here whether there is a mandate that those must be  
15 cleared. But I think that there should be some  
16 concern about what the congressional intent in the  
17 statute was. And in sorting that out, however it  
18 works out, I would just echo Lynn's comments that  
19 there would be some consistency with respect to  
20 margin and collateral setting, with respect to  
21 clearing those trades as per what the CCPs are  
22 doing for those specific transactions. Right?

1                   So I think one of the greatest  
2    overarching concerns was the shadow trading of  
3    things whereby pricing might have been inaccurate  
4    and margins and collateral requirements were  
5    obviously inaccurate. So allowing eligible  
6    transactions, transactions that the CCPs have  
7    clearly established in the market that they are  
8    willing to clear, allowing those eligible  
9    transactions to occur outside of clearinghouses  
10   does leave an onus on the regulators to be very  
11   active in assessing margin and collateral  
12   requirements and it creates a market surveillance  
13   -- it creates a gap in market surveillance, I  
14   believe, based on the reality of the resources,  
15   human resources available at the federal  
16   regulatory level to oversee on a daily basis the  
17   mark to market evaluation of those transactions  
18   that are not cleared.

19                   MR. TURBEVILLE: I believe there is a  
20    mandate, but it's -- the fact of the matter is  
21    that the meaning of Dodd-Frank is that as much as  
22    can, within the bounds of prudence be cleared,

1 should be cleared. I think that's obvious from  
2 things that clear. That's obvious from the  
3 statute. And I think clearing is a remedy to a  
4 problem that was viewed as in existence.

5 As to items that aren't cleared it also  
6 suggests strongly that the process of clearing and  
7 the ways to manage the consequences of default are  
8 a superior way of going about things than in a  
9 bilateral world. Ergo while clearing processes  
10 suggest the right kinds of approaches to measuring  
11 risk that in an uncleared context, particularly  
12 with regard to liquidation of positions, the  
13 appropriate amount of collateralization should be  
14 in excess of that which is required in clearing  
15 because conceptually it's a different world, the  
16 resolution of a default, and it's not as  
17 inefficient as a process oriented process.

18 MR. RAMSAY: I suppose that if one  
19 accepts as general proposition, you know, the idea  
20 that there's a mandate that if something should be  
21 cleared or can be cleared it should be, to  
22 Athanassios' point he made recently, that, you

1 know, products can have a lifecycle, too. And so,  
2 you know, demand, market demand, may ebb and flow.  
3 You may have a product that where there's enough  
4 market demand at one point in time that there's --  
5 that would justify even mandatory clearing. That  
6 might not be true in perpetuity. I would assume  
7 there might be a point at which that mandate might  
8 no longer survive or be appropriate for that  
9 particular product. I suppose if the  
10 clearinghouse no longer has the demand it could  
11 stop trading the product and then the question I  
12 suppose would be is there -- does the regulatory  
13 mandate then fall away?

14 Anyone?

15 MR. DIPLAS: I don't think we can  
16 declare it actually. The reality is if we put  
17 something in the clearinghouse it's going to stay  
18 there. It's very difficult to declare something.  
19 So we think we need to make that decision once and  
20 then it goes there. And then it's going to stay  
21 until it matures.

22 MS. TAYLOR: I would agree with that

1 finances that trades once they are cleared would  
2 be difficult and probably unproductive to unclear  
3 positions that have been cleared or to force those  
4 to be uncleared. But I think that there could be  
5 a circumstance in which a particular product was  
6 cleared for a period of time and then the  
7 clearinghouse could determine that the service for  
8 that product would be extended only to liquidating  
9 trades or something like that.

10 I think it would be unlikely. So I  
11 think we should be making good choices on the way  
12 in. But with respect to the question of whether  
13 or not everything should be forced to be cleared  
14 if a clearinghouse makes a service available, what  
15 I would say is -- I'm not the right person to  
16 evaluate whether there is or is not a mandate in  
17 the legislation. But I think that the markets are  
18 best protected and the participants and the system  
19 as a whole are best protected when the structure  
20 that we put in place is one that maximizes the  
21 amount of available liquidity. An so I would  
22 suggest that to the extent that there is

1 flexibility in the regulations that the regulators  
2 would follow a policy of trying to kind of first  
3 do no harm and over time I think the existence of  
4 the CCP model and the existence of the SEF  
5 incentive will tend to increase the available  
6 liquidity and the visibility of that liquidity.  
7 That's not something that's going to happen  
8 automatically over night. And so I think there  
9 will be a transition period during which we should  
10 think very carefully about doing the transition to  
11 clearing or to SEFs in such a way that there's the  
12 least disruption possible to the available base of  
13 liquidity that exists.

14 MR. GRAULICH: So liquidity was  
15 mentioned many times now as a key criteria whether  
16 a product is clearable or not. And I fully agree  
17 with what Athanassios said and this is a built-in  
18 problem with the indices with the old series. So  
19 if you have a new series, the old one will become  
20 illiquid so it's difficult. And there is no  
21 liquidity in a default scenario for those products  
22 so you, as a clearinghouse, are not at all in a

1 position to liquidate those positions of the old  
2 series because there is no natural market  
3 liquidity.

4           And what Athanassios described, the  
5 mechanism which is introduced now that the market  
6 participants who are in a position to do that are  
7 while voluntarily providing prices to the  
8 clearinghouse to do a proper evaluation of those  
9 positions, it's very important and it's one piece  
10 to the puzzle. I think if it comes to the  
11 liquidation, then it is important that the dealers  
12 who provided the prices stand by their prices. So  
13 they have to have -- if that system should fly,  
14 then they have to have a certain obligation to  
15 stand by their prices and pick up some of the  
16 portfolio of the liquidating -- of the defaulting  
17 member. Of course with some discounts reflecting  
18 the size of a defaulting member and some well  
19 spread increases which you usually observe in a  
20 default scenario, but I think that is something  
21 which needs to be added to that approach which is  
22 currently there.

1           An alternative I think, and if we look  
2   at the Lehman default and how Eurex, which is  
3   predominantly exchange trading, so here you have a  
4   -- the future system that you always have the high  
5   liquidity in the closest three months expiry and  
6   every three months there is a big roll into a new  
7   series. And I didn't think it fully through but  
8   perhaps that would be something which could be an  
9   alternative way to not, well, make those old  
10  series illiquid but kind of roll those old series  
11  into a new series which then has a liquidity  
12  again. I don't know. I'm not a market expert and  
13  Athanasios or others can comment better on that,  
14  but that could be an alternative having seen that  
15  it worked on the futures side very well.

16           MR. DIPLAS: That is -- it kind of  
17  happens already. That's what I was saying. Half  
18  the trades let's say are old. But then you have  
19  the problem with the other half. I'm making up  
20  the half, but more or less. But the others don't  
21  and they basically age. And the advantage of  
22  futures, you're very correct, is that they

1 naturally expire and therefore you never have the  
2 aging problem. So that's the thing.

3           There's only one word I would correct in  
4 what you said. I agree with everything else. We  
5 don't voluntarily provide prices; we contractually  
6 provide prices. (Laughter) And also for default  
7 management, we contractually have to step up  
8 exactly as you said to actually take and unwind  
9 the defaulted portfolio. In every other respect I  
10 agree with you.

11           MR. IVANOV: And just to expand on what  
12 Athanassios is mentioning, indeed our  
13 participants, they provide prices. These prices  
14 are such that they stay behind. Actually, we  
15 created something we feel that is almost  
16 unprecedented in the CDS market, namely having a  
17 price discovery process that provides prices at  
18 nine points on the curve even though typically  
19 people will look at the five-year point as the  
20 most liquid. In terms of managing default  
21 enrolling, it is about risk management policies  
22 and practices and how risk management is executed.

1 But once the serious roles or it just moves from  
2 the most liquid point, definitely the liquidity  
3 charges would and should and must increase. On  
4 the other hand, in terms of default, the default  
5 management approach is to really look at hedging  
6 with the most liquid points on the curve and then  
7 auctioning the full portfolio rather than just  
8 sitting on these illiquid positions that they're  
9 very difficult to move. But the price discovery  
10 process is indeed very robust. And we've seen  
11 tremendous improvement in terms of market  
12 consensus and prices that we generated throughout  
13 the last 16, 17 months in terms of index and  
14 single name pricing.

15 MR. TURBEVILLE: Correct me if I'm wrong  
16 but I think what I just heard is I think a very  
17 sort of interesting point. As the liquidity  
18 deteriorates in this set of instruments, what's  
19 happening is that a set of the participants in the  
20 clearing enterprise, the members, are actually  
21 providing liquidity at a price in order to support  
22 the credit system that's in place. Okay? That

1 principle is the principle that I was talking  
2 about earlier which could very well -- I think  
3 that's a tremendous result. I think it's a  
4 sensible result. It's a way to increase the  
5 amount of instruments that can be cleared, and I  
6 think it has applicability far beyond that  
7 specific situation in terms of instruments that  
8 maybe cannot be clearable given the judgments that  
9 are applied by clearinghouses at the outset. It's  
10 a principle that can be built on and used to  
11 actually fulfill what I think is the intent of  
12 Dodd-Frank, which is a mandate or to clear as much  
13 as you possibly can.

14 MR. BODSON: There is, sorry, there's  
15 one other element we kind of forget here. We're  
16 in the Trade Information Warehouse. We have 3,000  
17 reference names. So there's two elements here.  
18 There's an element of maturity curve, but there's  
19 also the element of there's a lot of names out  
20 there that, you know, will bespoke or a one off  
21 type of transaction. So that factor in terms of  
22 everything getting cleared, there's another part

1 of the depth of the market that has to be taken  
2 into consideration.

3           The comment about the lack of  
4 standardization is I think, as Athanassios said at  
5 the beginning, there's been a huge move towards  
6 standardization. Ninety-eight percent of our  
7 transactions are gold transactions electronically  
8 confirmed. And you do that because of  
9 standardized terms. So regardless of what's going  
10 on in the clearing space or the SEF space, at the  
11 end of the day obviously we've been a very strong  
12 proponent of standardized reporting and  
13 aggregative reporting so there is transparency,  
14 there is a simple source of information that the  
15 regulators and the market can go to.

16           So the lack of something being cleared  
17 does not inherently mean it's not standardized,  
18 not reportable, you know, somehow disappears into  
19 the ether of Wall Street and never is seen again,  
20 the activity is standardized. The activity is  
21 being reported on in both a public manner and to  
22 the regulators.

1                   MR. RADHAKRISHNAN: To counteract  
2 declining liquidity, is it appropriate to have a  
3 ratcheting up of margin requirements and/or  
4 default fund requirements. Because after all, one  
5 of the concern about the liquidity is what happens  
6 if somebody defaults and how do you manage that  
7 position? So I'd like some comment on that.

8                   MR. DIPLAS: It is appropriate but it's  
9 already done actually. The CCPs themselves, I'll  
10 let them explain it. They already have -- they  
11 look at, you know, the bid offer in the market and  
12 based on that they basically determine based on  
13 the depth of the market what the right liquidity  
14 charge is basically. So as the index, even an  
15 index that is liquid now ages, we do pay higher  
16 margin than guaranty fund contributions. So  
17 that's already done. And I think that's the only  
18 way you can deal with it. Remember, the margin  
19 has to reflect the gap risk. The gap risk is  
20 higher for a conduct that's more liquid. So I  
21 think they're doing that already. So conception  
22 of the framework is correct. It's a matter of we

1 can discuss the calibration whether they give the  
2 right numbers or not but conceptually I think  
3 they're approaching it the right way.

4 MR. BENISON: That's also going to be --  
5 it's going to impact the liquidity charge but it's  
6 also going to impact the concentration charge.  
7 Right? So the concentration charge is going to be  
8 based on how much you can move compared to the  
9 size of the position. So it should be factored  
10 in.

11 MR. GOOCH: Yeah, I'd almost have to  
12 give the CCPs a little bit of wiggle room to make  
13 their own decisions on some of this stuff because  
14 I think if you look at the indices at the moment,  
15 as we roll an index we take 125 names and we  
16 decide only 110 of them are still very liquid and  
17 that's the new index. So if you look at an index  
18 from a few series ago, most of the names within  
19 that index are still liquid and still actively  
20 traded in the new indices. So whilst the index,  
21 the package itself is illiquid, most of the risk  
22 it contains is still liquid and can be managed.

1 But you could get a situation where, you know,  
2 radical movements in the global economy and the  
3 names change very fundamentally, so you could end  
4 up with a very old index that has nothing in  
5 common with current single names on liquid or  
6 current indices. And that would be a very  
7 different risk management problem. So I think  
8 it's very hard to draw a general solution. Most  
9 indices themselves age gracefully and change  
10 slowly over time and the liquid they represent is  
11 not that illiquid. But we can't guaranty that in  
12 the future. There has to be some sort of let out  
13 for the CCPs if they're left with a situation  
14 where something doesn't trade at all in any format  
15 then perhaps there is a different set of  
16 solutions.

17 MR. BENISON: Except, Jeff, the one  
18 thing is while the names themselves, you know, at  
19 the current on the run point will continue to be  
20 liquid, the names at the same maturity as that off  
21 the run index rolling down the curve are going to  
22 get less and less.

1           MR. GOOCH: Yeah. You certainly get a  
2 double factor of liquidity. You go the aging and  
3 the other fundamental liquidity. I agree.

4           MR. EDMONDS: Yeah, I think what -- I  
5 was going to bring up the same point that Tom did  
6 but, you know, think about concentration at the  
7 end of the day. There could be positions that are  
8 in the clearinghouse that someone pay whatever it  
9 is they need to pay in order to terminate the  
10 transaction. It goes away and there's no longer  
11 any risk. That could definitely change the  
12 concentration profile of who holds the positions  
13 left and the residual contract or position within  
14 the clearinghouse. That change at the end of the  
15 day, you know, we're going to monitor in real  
16 time. I'm sure any relevant CCP would do it in  
17 some similar manner. But, you know, it seems to  
18 me like there's this idea that we don't want to  
19 clear more. I mean, we're commercial interests.  
20 We have shareholders. We want to clear as much as  
21 we possibly can clear at the appropriate time.  
22 The balance of risk we have is making sure we do

1 it prudently.

2           So there's not a desire here to go,  
3 gosh, you know, we only have 89 single names or,  
4 you know, 300 of whatever -- can we get to 3,000?  
5 I'll defer to Stan on that one. (Laughter) It is  
6 something that at the end of the day, you know,  
7 that is the motivation about the structure of the  
8 commercial entities that provide these services  
9 that if we were to begin, and there have been some  
10 comments around, you know, whether or not there  
11 should be more utilities versus, you know,  
12 for-profit entities, it's problematic because if  
13 you make that a less than for-profit utility you  
14 may end up with a situation where there is no  
15 motivation to go out. It's not the race to the  
16 bottom because you still have the balance and it's  
17 incumbent upon the regulators at the end of the  
18 day to make sure that we don't do that as an  
19 industry. You know, no one wants to sit and run a  
20 clearinghouse to manage the biggest default and  
21 not survive for the first time in history, and no  
22 regulator wants to sit in their chair going guess

1     what?  It was on my watch that that happened.  So,  
2     I mean, there is some intrinsic piece.  And  
3     certainly, you know, the counterparts, whether  
4     trading counterparts of the market or clearing  
5     members don't want to be party to that either.  So  
6     there is an opportunity for in the right spirit  
7     but it's not something that we want to clear less.  
8     And that shouldn't be the presupposition people  
9     operate with.

10           MR. RAMSAY:  Your question, you know,  
11     there was a question I was thinking of maybe  
12     saving for later on but I'm tempted to ask it now  
13     in terms of this tradeoff between providing  
14     access, both in terms of the amount of cleared  
15     products as well as access to participants versus  
16     sort of good risk management.  That's part of what  
17     the statute requires us to think about and both of  
18     our agencies recently put out rules on that point  
19     on dealing with conflicts of interest and dealing  
20     with them by proposing specific requirements in  
21     terms of limitations on ownership as well as board  
22     composition for those agencies in order to try to

1 balance those two factors as much as possible. We  
2 are in the public comment process with respect to  
3 those particular rules. So if people have any  
4 general thoughts about that tradeoff and how to  
5 approach it, or any more specific comments on  
6 those rules, from a regulatory perspective we'd be  
7 happy to hear them.

8 MR. BENISON: So I would say that first  
9 of all I think there are a number of different  
10 sets of conflicts of interest you have to worry  
11 about. So to the point Chris mentioned before and  
12 I don't think this is a problem in any of the  
13 current clearinghouses and the current constructs,  
14 but there is, you know, the structure of a  
15 clearinghouse is you have now private for-profit  
16 entities that are basically managing the capital  
17 of the members because it's the membership of the  
18 majority of the capital. Even though the CCPs all  
19 have some stake at risk, it's really a sliver  
20 compared to the pool put up by the members.

21 So you have one concern which is, you  
22 know, they are basically earning fees by putting

1 members' capital at risk. So you have to sort of  
2 watch that. From a members' perspective, I think  
3 the way you have the ability to watch that is you  
4 have some say over how your capital is risk  
5 managed. And that's through the risk committee.  
6 Now, that's not to say that end users shouldn't  
7 have transparency into that process and a say in  
8 that process or independence, but I think it's a  
9 dangerous situation. You have to think very  
10 carefully about saying you're mandated to clear,  
11 you're putting your capital up to be managed by  
12 this clearinghouse, and we're going to reduce your  
13 ability to impact the risk management of that. I  
14 actually think from a risk management perspective  
15 the members are aligned with trying to  
16 appropriately risk manage that.

17 MR. DIPLAS: I would agree with what Tom  
18 said. And perhaps if I can say the same thing in  
19 a little bit more -- in a slightly different way.  
20 If you look at the traditional capital --  
21 corporate capital structure, you have the equity  
22 holders and you have the debt holders. It's a

1 very simple structure. The equity holders make  
2 the decisions but they're on the hook because when  
3 the moment there are lawsuits they will be the  
4 first ones to take a hit and then the debt holders  
5 take a hit. And usually they build some covenants  
6 to protect them, etcetera.

7 In the CCP, that order is reversed.

8 Okay? If we look at a waterfall, the default  
9 clearing member takes the first loss, then there's  
10 a thin layer that the CCP takes a loss, but then  
11 it's the debt holders that actually get wiped out  
12 potentially completely but the CCP could still  
13 operate. So that reversal of that capital  
14 structure is very fundamental. And the way you  
15 can protect the interest of the debt holders in  
16 that respect is to involve them in the risk  
17 management decisions. And for us that is -- the  
18 risk committee is the most important element of  
19 the clearinghouse to make sure we get it right.  
20 And I believe in every other respect the  
21 (inaudible) line. And the last thing is alignment  
22 of interest, like Tom said, to ensure -- you have

1 to ensure that you don't have a CCP, a new CCP and  
2 none of the ones from this table unless you can  
3 make up a new one comes up. I want to clear this  
4 new product. Nobody else clears it and then you  
5 have to mandate everybody to come to me. You  
6 cannot have a captive marketplace basically in  
7 that respect. So again, it's up on the regulators  
8 to ensure that doesn't happen.

9 MR. RAMSAY: Professor Pirrong.

10 MR. PIRRONG: Yeah. This debate has  
11 frequently been framed in focusing on conflict of  
12 interest but I think it's more important to focus  
13 on alignment than incentives. And I think that  
14 that's the point that's being made here. And  
15 there's also an issue with membership and access  
16 to the clearinghouse and things of that nature  
17 that's very important. I mean, there's also been  
18 a focus on sort of the product-specific nature of  
19 default risk. But essentially, default risk  
20 depends not just on the risk of the product but  
21 also the risk of the firm that has the position  
22 and the interaction between those two things. And

1 when you have potentially very heterogeneous  
2 membership of a CCP and you're essentially not  
3 adequately taking into account the specific risk  
4 associated with a particular member, that can lead  
5 to, you know, conflicts within the exchange or  
6 within the clearinghouse, governance issues,  
7 governance conflicts, and also, you know,  
8 essentially inefficient allocation of risk across  
9 the members. So, you know, I think these access  
10 membership and governance issues are very  
11 important and will really determine how well this  
12 mechanism works to reduce the kinds of risks we're  
13 concerned about.

14 MR. TURBEVILLE: There's no doubt that  
15 everything that's been described here is  
16 absolutely true, but it's a two edge sword. I  
17 have no doubt and I think many have no doubt that  
18 there have been instances -- I've been involved in  
19 instances -- where the membership of  
20 clearinghouses, especially in launching a new  
21 product, is tremendously influential in how it  
22 gets launched beyond merely concern about the risk

1 of the clearinghouse. It happens.

2 And I think the other thing that's -- so  
3 the governance issues are very relevant. Even if  
4 nothing ever had happened just for appearances  
5 sake, you know, I think for the credibility  
6 because clearinghouses now are an instrument of  
7 policy, whether you like it or not. It's  
8 happened. It passed.

9 The other thing that's quite important  
10 is governance issues. But you're right, it's the  
11 risk committee. And I think very significantly,  
12 again, even if you're just concerned with  
13 appearances, I'm concerned with substances but  
14 appearances. That independent representation on  
15 the risk committee in a robust form is a very good  
16 thing. That's not to say that members of the  
17 clearinghouse shouldn't have a lot to say about  
18 how that works. Their capita is at risk. But  
19 this is an instrument of policy as well so that  
20 robust representation on risk committees is  
21 essential.

22 MS. JOHNSON: If I could chime in just

1 with some specific corporate governance concerns  
2 that come out of a lot of the academic literature  
3 and study of securities regulation over the last  
4 at least decade, certainly strongly influenced by  
5 Sarbanes-Oxley and in addition to that the number  
6 of acts Congress adopted in the financial crisis,  
7 there clearly is a new federal focus on corporate  
8 governance for all types of businesses. But with  
9 respect to risk management governance involving  
10 businesses that are effectively the arteries or  
11 nervous system of the national and international  
12 economy, I think there are genuine issues that we  
13 now find ourselves facing.

14 I'm going to speak to some specifics  
15 because I think this is an important opportunity  
16 for what has been in legal academia conversation  
17 we've had to bring to the table. With respect to  
18 corporate governance in the CCPs or derivatives  
19 clearing organizations or SEFs, however we look at  
20 it, there are -- it is tremendously critical. I  
21 guess I should just say that independence with  
22 respect to directors and perhaps ICE has some

1 unique structural benefits built in in its direct  
2 oversight, regulatory oversight, making it  
3 distinct from other CCPs. But in general, the  
4 independence and competence with respect to risk  
5 management oversight on boards of directors is  
6 increasingly important. And we've highlighted  
7 independence historically but I think we see now  
8 some new ties to expertise in the ability of  
9 independent directors to oversee risk management  
10 policy decisions and to have authority to pass on  
11 the quality of those decisions inclusive of the  
12 effectiveness of the models to consider highly  
13 significant but low probability events with  
14 respect to default.

15 In addition, I think with respect to the  
16 risk management committees, there will probably be  
17 I expect coming out of the regulation, if not in  
18 this instance than I think the academic world  
19 certainly anticipates it, requirements with  
20 respect to independence by service of risk  
21 management committee members. And this is to  
22 isolate or potentially evade concerns regarding

1 pressure on those committees to respond just as  
2 someone has mentioned to new product requests in a  
3 manner that might prioritize profit over what  
4 would be a protective or defensive position for  
5 the business itself.

6 In addition to that I have certainly  
7 seen in literature a number of commentaries about  
8 ties between compensation for directors to the  
9 performance of the CCPs and some concerns about  
10 how those linkages might create cause for concern  
11 and certainly fall within the general parameters  
12 of the conflict of interest discussion. There are  
13 also concerns about eligibility of clearing  
14 members as Craig mentioned that we are at least  
15 very thoughtful about and we're sure that the CCPs  
16 themselves and the regulators as well are  
17 thoughtful about.

18 MR. GOOCH: I would like to, if I may,  
19 just step in and echo Craig and Kristin's  
20 comments. The fact is that CCPs, you know, are an  
21 instrument of policy in a post- credit crisis  
22 world. If clearing is going to be successful, and

1 despite the fact that you're putting capital at  
2 risk as you contribute to the funds, the fact is  
3 that you do need a certain degree of transparency  
4 in a corporate -- in the government's level. And  
5 access. You need to have independent directors.  
6 We need to know what's going on as a marketplace  
7 away from, you know, simple profit motives of a  
8 clearinghouse.

9           And to dovetail off that I think it's  
10 important when you look at FCM eligibility  
11 requirements specifically that the market or the  
12 CCP itself should not just focus on its FCM  
13 membership today but also ask yourself what other  
14 FCMs out of the, you know, 50, 100-odd FCMS do  
15 qualify from a capital standpoint and who can also  
16 share the burden in terms of providing prices and  
17 putting their capital at risk in a default  
18 scenario. So especially in light of the fact that  
19 you have a certain degree of correlation risk that  
20 may exist if you just pick from one pool. So  
21 there are FCMS out there today whose core business  
22 is clearing, who represent large away from the

1 clearing of CDS in other market contexts are  
2 represented here -- well capitalized or are well  
3 capitalized entities that fulfill the specific  
4 capital requirements of both ICE and the CME and  
5 Eurex. But we need to be mindful that they be  
6 given access and innovative ways be thought of  
7 because some of these guys don't necessarily have  
8 their own dealing desks but they can still provide  
9 prices in the end of day process by doing joint  
10 ventures, for example, with dealers who don't  
11 clear for themselves, for example.

12 So in essence, you know, from a clearing  
13 standpoint, yes, you are private enterprise but,  
14 you know, one thing we need to be mindful of is  
15 you serve a public need in the success of clearing  
16 and the lessening of systemic risk.

17 MR. HARRINGTON: I think Jamie makes a  
18 good point there. One of the things that we're  
19 seeing as far as a structural change in the  
20 marketplace right now is the move from just  
21 interdealer clearing, which has been, you know,  
22 going for, you know, I guess over a few years now

1 on products like ICE, but then if you look at the  
2 interest rates there's been clearing in the dealer  
3 to dealer market and interest rate swaps for a  
4 number of years. The structural change taking  
5 place is bringing the clients to the table as far  
6 as allowing clearing in the client to dealer  
7 space, the buy side, the sell side space. And  
8 that's where the access points really, really  
9 start to obviously multiply and the importance of  
10 it really increases.

11 And I think Chris makes -- Chris  
12 commented on as far as the utility nature. I  
13 completely agree that, you know, having utilities  
14 in place will, you know, most often decrease  
15 innovation, decrease efficiency, but sort of the  
16 key is to getting directly to a clearinghouse  
17 crediting and getting directly to a SEF or getting  
18 to a swap date or a repository to get things like  
19 data or end of day data that provides transparency  
20 to the market, that's where the issue really,  
21 really lies. So as we've seen, you know, CCPs in  
22 the OTC derivative space for a number of years

1 now, the data that's out there is almost, you  
2 know, is very difficult to gain access to. And  
3 that's what I think the larger community is really  
4 seeking, is the ability to review that data. Or  
5 even to participate. So actually getting  
6 participation into those CCPs is sort of what  
7 people are looking for.

8 MR. RADHAKRISHNAN: Lynn and then --

9 MS. MARTIN: I just want to make a  
10 couple of points. Number one, it's our belief  
11 that numerical limits do not necessarily tie to  
12 voting rights on the board. So hard limits don't  
13 necessarily represent the voting rights. When you  
14 think about the governance of exchanges, DCMs,  
15 DCOs, what's more important is to take into  
16 account the views and give an equal voice to those  
17 views of different market participants. So give a  
18 voice to the independence, give a voice to the  
19 dealers, give a voice to the buy side, give a  
20 voice to the exchange management, and have that be  
21 equally weighted as opposed to have hard numerical  
22 limits governing that.

1           In order for us to facilitate a smooth  
2 transition to central clearing which is the key  
3 objective here. What's going to be most important  
4 is that we work together, that the exchanges, the  
5 market participants, both the dealers, the buy  
6 side, as well as the independents, all work  
7 together to define principles that will facilitate  
8 the efficient migration.

9           MR. RAMSAY: Yes. Please go ahead.

10          MR. BODSON: As the representative of  
11 the benevolent monopoly in the marketplace, a  
12 couple of comments. One, I do take umbers that  
13 utilities aren't innovative. I think we have  
14 people who are pushing the edge in terms of  
15 systemic risk in taking on issues that others have  
16 not taken on. So I'd love to have you come by and  
17 talk to us anytime you want and we can explain  
18 some of the things we're doing that are very  
19 unique, such as the Trade Information Warehouse  
20 which was created out of the industry working with  
21 the utility to create something that was  
22 incredibly innovative and has really spawned the

1 growth in this marketplace.

2 I think the comment that was made, as  
3 everybody knows, we are a primary user. We do  
4 have independence on our board now. But there is  
5 this interesting tension between the alignment as  
6 everybody has talked about. We have members, we  
7 have owners, we have boards, we have management,  
8 we have governance. And as the point was made,  
9 none of us want to have our name on the biggest  
10 default that ever occurred. None of us slept for  
11 many days when Lehman happened because none of us  
12 wanted to be responsible for the collapse of the  
13 financial markets.

14 So there is an alignment of interest,  
15 but there's also a tension. There's a massive  
16 tension between our directors, who happen to be,  
17 as I said, primarily Wall Street firms. They have  
18 a very strong interest, again, of not seeing us  
19 fail. So we may be a not cost utility, so we may  
20 not have the profit motive balance that my  
21 colleagues on the ICE and Eurex and CME may have,  
22 but nevertheless, I think people, when you get

1 into the CCP space, yes, there are profits to be  
2 made but more importantly there is a role to play,  
3 a policy role to play that is felt up and down the  
4 line. So you either are aligned to do your job  
5 properly or that tension comes to the forefront  
6 very, very quickly. Be it the regulators, be it  
7 the governors, or be it the members. None of us  
8 want to be involved in a collapse.

9 MR. RADHAKRISHNAN: I'd like to ask a  
10 question about processing. What improvements have  
11 been made in trade processing and reporting to  
12 repositories? And what more can be done do you  
13 guys believe to the CDS market?

14 MR. GOOCH: Shall I pick that one up? I  
15 think, you know, trade processing for CDS has come  
16 an enormous way over the last sort of five years.  
17 You know, when I think it first came to sort of  
18 public forums and regulatory forums we used to  
19 spend weeks confirming trades, enormous manual  
20 processes, backlogs -- I've never had to use that  
21 word but backlogs and piles of paper on desks. It  
22 was extremely unpleasant.

1           I think what the industry has  
2 collectively done over the last five years is move  
3 to a situation where a lot of the basic problems  
4 in processing have now been solved. We've got,  
5 you know, over 95 percent of all the trades being  
6 electronified on the day, being confirmed on the  
7 day, pretty much high rates for the inter-dealer  
8 business. So predominately now in the CDS market  
9 we do have electronic records, we do have trade  
10 day processes which I think put us in a much  
11 stronger situation than we were historically.

12           The focus over the last couple of years  
13 has really been two things. One is looking at  
14 that gap of some of those very complex  
15 transactions that can't be electronified easily  
16 and making sure they're still available for  
17 regulatory reporting. This is something called  
18 the bronze record process but it's been a lot of  
19 work to make sure that the Trade Information  
20 Warehouse that Mike runs has 100 percent of the  
21 credit default swap. Not 98 or 99 because it's  
22 the 1 percent that hurts you at the end of the

1 day. There's been a lot of work to make sure that  
2 everything is available, so I think we are now in  
3 a situation where from a regulatory perspective at  
4 least you can go in and look at everything that's  
5 been there. We've done a lot of time in this  
6 work. Where people are now sort of focusing is  
7 saying, okay, what are the residual processes  
8 which still create delay or risk. And, you know,  
9 we've done a lot of work on innovation consent  
10 over the course of the last year. That was a  
11 process that still was very separate and e-mails  
12 and Bloomberg messages and things that needed to  
13 be electronified so that's been worked through.  
14 People are increasingly focused on allocation  
15 delivery from funds to sell side firms because  
16 that's something that does create delay. It's  
17 probably accountable for most of that few percent  
18 that doesn't go through on trade day.

19 So I think we're put in a position now  
20 where the trade day process works very effectively  
21 to agree to bilateral trades on the day. Where I  
22 think we may need to go now is to two things. One

1 is to look at the whole clearing process. You  
2 know, we're in a situation where interdealer  
3 clearing happens five days after the trade and  
4 that's something that people are now working on to  
5 try and fix. Making sure that everybody has  
6 access to those processing solutions because I  
7 think as buy side firms want to clear, clearing  
8 brokers are getting involved with historically not  
9 being connected. Some of the new firms that Jamie  
10 mentioned getting involved in this market that  
11 have not historically been involved, that network  
12 is growing from 2000 touch points now, is growing  
13 very rapidly to include all those new participants  
14 to make sure they have access to those solutions.  
15 And I think that's very important to give those  
16 low cost access, access is unbundled from other  
17 products and services, they can uniquely decide  
18 which clearinghouse they want to work with, which  
19 SEF they want to work with, how they want their  
20 trade processed and not forced into making  
21 decisions based on how their services are bundled  
22 up between SEFS, CCPs, data companies, other

1 things. That's important.

2 And then some of the post trade  
3 activities. I think the thing that makes credit  
4 default swaps hard, everyone kind of says well,  
5 they're a complex product compared to interest  
6 rate and a very simple product compared to  
7 interest rate. On the trade date, post trade date  
8 activities, credit events, restricting events, and  
9 there's been a lot of work through ISDA to try and  
10 standardize the way they're processed. And I  
11 think that's probably where the residual risk  
12 probably still sits.

13 MR. DIPLAS: I would agree with that. I  
14 mean, I think the asset class has been  
15 electronified more than any other asset class  
16 right now. So anything we change right now would  
17 be marginal. What is going to be the next big  
18 change in my opinion is as we build the SEFs, is  
19 the connectivity between SEFs, CCPs, and FCMs.  
20 Those pipes are not in place because since we  
21 don't know what the big piece of the puzzle that  
22 is missing is the SEFs. So I know you're going to

1 have to go through a pile of applications, I don't  
2 know how high, but then when that is in place we  
3 have to build those pipes. And that's  
4 fundamental. And I think we need to work together  
5 both as we've done before with industry and  
6 regulators to ensure that we actually don't kind  
7 of rush this job. It's very important that we do  
8 that infrastructure right because we have a unique  
9 chance to actually kind of wipe the slate clean  
10 right now and do it properly. And I think in the  
11 past we had rushed things and then we had to go  
12 back years later and fix them. I think now is the  
13 chance to actually make sure that connectivity is  
14 done properly. I agree that it should be, you  
15 know, we have to build multiple access points and  
16 everything else involved for kind of equal access.  
17 In every other respect I would agree with Jeff but  
18 I think this is the biggest challenge we're going  
19 to have over the next few months or year.

20 MR. BENISON: I would just -- if I could  
21 just add on Jeff's comment about life cycle  
22 events, which I think particularly for credit is

1 pretty important. You know, before -- prior to  
2 having the Trade Information Warehouse you would  
3 have everyone sort of processing life cycle events  
4 themselves. So when the index -- when you had a  
5 credit event in one index and it dropped down  
6 everyone would come up with their own factoring.  
7 Bloomberg would come up with a factoring and it  
8 would take about, you know, a week to two weeks  
9 before everyone's factoring got sorted out to the  
10 right decimal place.

11 So one of the benefits of the Trade  
12 Information Warehouse for credit is you have one  
13 place that's handling the processing of all these  
14 life cycle events, whether it's successor events,  
15 credit events, whatever it is. And that's  
16 particularly important for this product. And I  
17 think if that does get broken up then we've got  
18 some other work to do around how to coordinate  
19 across that.

20 MR. CAWLEY: Ananda, if I may, I'd like  
21 to just echo Athanassios' comments in terms of SEF  
22 connectivity. One thing is it's true. We should

1 have real time and some SEFs actually are building  
2 or currently have real time access to clearing.  
3 It should certainly be agnostic. It should  
4 certainly be fast and low cost. One of the  
5 things, and it's interesting listening to Tom and  
6 Athanassios talk about the post-acceptance  
7 clearing concerns and event processing after that  
8 trade has occurred. One of the things from a  
9 future SEF that we're looking at right now, which  
10 I think requires market and industry focus frankly  
11 is what happens from the point of trade to the  
12 point in that period between trade execution and  
13 acceptance into clearing? And Athanassios is  
14 completely correct. What we're looking at, and  
15 we're beginning to have conversations as a future  
16 SEF today is considering the role of SEF  
17 connectivity to the FCM on a pre-trade clearance  
18 basis such that, you know, the notion is you take  
19 a trade, you offer anonymous execution between two  
20 parties, you submit both the buy and the sell to  
21 the CCP on a symmetrical basis, which is currently  
22 the workflow with the CME, for example. What

1 happens if one side, the FCM declines the trade  
2 because for whatever reason. So what do you do  
3 then? Does the SEF step in to guarantee the  
4 trade? We would prefer not to. So how do you get  
5 around that?

6           And the good news is looking to other  
7 markets there is technology today where you have  
8 advances in the listed derivatives marketplace,  
9 for example, where you have -- where the SEF or  
10 the execution broker in that context has real time  
11 connectivity to the FCM, such that when that  
12 customer comes in to trade, either on an opening  
13 morning basis on a clip size or total no show for  
14 the day, duration adjusts, for example, within the  
15 CDS context, that that counterparty, that there's  
16 sanctity in that trade, that both parties know  
17 that that trade is going to clear. And you can do  
18 that today by bringing in this greater than  
19 tangential but direct relationship between the FCM  
20 and the SEF for that connectivity. I think over  
21 time you can get a real time connectivity such  
22 that in the few milliseconds that it takes to buy

1 or to lift an offer off a screen you've already  
2 queried the staff to say yes, no, does customer A  
3 have the ability to pay for that 100 million IG 15  
4 trade.

5 MR. RADHAKRISHNAN: I think we're going  
6 to take a short break, a 15 minute break.  
7 Unfortunately, there's just one restroom. One for  
8 men, one for women. But if you took the escalator  
9 downstairs, if you walked out and took a left  
10 turn, I think there may be another bathroom over  
11 there. So 10:45, please. Thank you.

12 (Recess)

13 MR. RADHAKRISHNAN: Can we take our  
14 seats please? All right. We're going to carry on  
15 our discussion and I'd like to make sure that the  
16 momentum that was built in the first session  
17 carries on.

18 So my colleague Steve Greska has been  
19 chomping at the bit to ask a question, so I'm  
20 going to let him ask a question.

21 MR. GRESKA: I was hoping I could keep  
22 the momentum going. When we first started this

1 morning and talked about the 95 percent commitment  
2 by the dealers, and I know there's correspondence  
3 and I've been to a couple of other dealers and  
4 they've mentioned that they fulfilled this 95  
5 percent commitment, they've already fulfilled it  
6 or they continue to fulfill it. And when you look  
7 at the public information at the Trade Information  
8 Warehouse and you see the gross and that notional  
9 and the indexes and then you see the notional  
10 value of what's actually being cleared, I was  
11 wondering what exactly is the commitment specific?  
12 What is the commitment and how is it being met?

13 MR. DIPLAS: Okay, so let me clarify  
14 because unfortunately there are a couple of 95  
15 percents that actually coincide. They're not the  
16 same 95 percents.

17 So first starting with the commitment.  
18 The commitment that the G-14 dealers and several  
19 large buy side firms have made to the global  
20 supervisors group was to submit 95 percent of new  
21 trades for clearing. Okay? And afterwards -- so  
22 this is what we can do individually. Submit the

1 trades for clearing. Obviously, there has to be  
2 an eligible counterpart actually on the other side  
3 of the trade. And then there was a collective  
4 commitment for what actually is going to be  
5 cleared. And we started at 75 percent and then we  
6 went to 80 percent.

7 SPEAKER: Yeah, I think that's right.

8 MR. DIPLAS: We went to 80 percent.

9 Okay? So that was what has to be cleared  
10 cumulatively, 80 percent of looking at certain  
11 index. Okay? If you look at what we have  
12 actually done, we have managed to clear  
13 cumulatively or compress, which is the same thing,  
14 more than 95 percent of those indices. Okay? So  
15 we have exceeded that 80 percent commit to clear  
16 and we have cleared more than 95 percent of those.  
17 Just to explain also when you look at the --

18 MR. BENISON: No, I was just going to  
19 say maybe go through the compression point.

20 MR. DIPLAS: Yeah, exactly. No, that's  
21 what I was getting to.

22 When you look at the numbers currently

1 in the warehouse, it's very difficult to actually  
2 look at them and just get a good idea as to how  
3 much has already been cleared. The reason for  
4 that is that there's an inherent compression that  
5 takes place that it's out of clearing. We look at  
6 on average something like a nine to one  
7 compression, and I'll tell you why I use that  
8 number because it's a very convenient number. So  
9 let's say we start with 11 trillion of an  
10 instrument. Okay? For argument sake we submit 90  
11 percent -- we clear 90 percent of those. So one  
12 trillion stays out and 10 trillion are submitted  
13 for clearing and gets cleared. Out of that it  
14 gets compressed down to something like one  
15 trillion. So if you look now what has cleared  
16 versus what has not cleared you will see 1.1  
17 trillion on one side and one trillion on the other  
18 side. So it will look like as if the market now,  
19 50 percent of it is in the cleared stage, 50  
20 percent is not, but the reality is you have  
21 actually cleared 90 percent of what was available  
22 to be cleared. Okay?

1           So I know the numbers get a little bit  
2   confusing in that respect but, so collectively  
3   among eligible counterparties, yes, in all these  
4   indexes that we started, you have cumulatively  
5   cleared or compressed more than 95 percent of  
6   them. And the numbers vary and you will see kind  
7   of a drop in these numbers obviously every time we  
8   issue a new index. Obviously, it's a new  
9   instrument again. We have to restart clearing it.  
10  Also, you can see the numbers drop for a short  
11  period if we are the new clearing member because  
12  more trades become available to be cleared.

13           MR. GRESKA: And that's going all the  
14  way back to like say Series 9 and the investment  
15  grade when we see --

16           MR. DIPLAS: Yes.

17           MR. GRESKA: That notional, that 1.5  
18  trillion notional?

19           MR. DIPLAS: Yes, Series 9 is one of the  
20  few indices. Actually, all the indices are kind  
21  of trades. It just happened to have a lot of  
22  names that were relevant and a lot of existing

1 trades. That's why it maintained some liquidity  
2 but obviously you can see a lot of the others.  
3 Some of the indices before don't have the same  
4 activity obviously.

5 MR. BENISON: And you see that, no, I  
6 was just going to say you can see some of the  
7 impact of this if you look at the notional  
8 outstanding in the warehouse. Right? And it used  
9 to be a much -- the peak was 60, 65 or something.  
10 And that shot down. Now, today it's 25. And much  
11 of that, some of that, a little bit of that is  
12 rolling off but a lot of that was just due to  
13 compression that took place either through direct  
14 tear ups or through the clearing.

15 MR. RAMSAY: If I could follow up on a  
16 point before the break that was being made, people  
17 were talking about the processing of these  
18 instruments upon a credit event and the benefits,  
19 clearing benefits of having that done in an  
20 orderly way. And based on a, you know, an  
21 understood set of criteria, would that suggest  
22 therefore that for a particular product the

1 greatest market benefits come about if that  
2 product is traded through a single clearinghouse  
3 as opposed to multiple clearinghouses where there  
4 might be different sorts of criteria applied or it  
5 might not be so well understood? And do people  
6 think that that would tend to happen as a, just as  
7 a natural migration from the market demand would  
8 all go to a single place? Could there be a single  
9 product traded through more than one house and  
10 would that pose complications?

11 MS. TAYLOR: I think what it points out  
12 is that clearinghouses need to be in a position to  
13 create certain elements of their services in ways  
14 that don't create a basis risk between the current  
15 market conventions and the way that the cleared  
16 transactions work. So I don't think it calls for  
17 a particular product to be cleared in a single  
18 clearinghouse but I do think it calls for the  
19 credit event processes, for example, to be  
20 consistent to a large extent across different  
21 venues so that there is not basis risk created.

22 MR. BODSON: I would think that that's

1 the role we play, the Trade Information Warehouse  
2 plays is in the post trade events, credit events  
3 or what. By having it done one place there's a no  
4 gap risk, there's no differences in how it's going  
5 to be handled. It's all done uniformly. So those  
6 types of issues disappear because we are able to  
7 aggregate all the positions. So there's two  
8 benefits in essence in terms of what the Trade  
9 Information Warehouse does. One is the reporting  
10 benefit of having one aggregated view and the  
11 other one is the standardized processing of the  
12 asset servicing side of the life. And that's the  
13 role we play in the position we do. So it allows  
14 a proliferation, if you wish, or you want to have  
15 the competition at the CCP level, it permits that  
16 the hand happen without the operational risk of  
17 downstream processing happening after the fact or  
18 the gap or the arbitrage, whatever that could  
19 happen if you have different processing occurring.  
20 So that's the true benefit in the stability and  
21 the foundation.

22 We've handled 48 credit events, I

1 believe. When I was at Morgan Stanley the first  
2 credit -- I'm trying to remember. It was a small  
3 Canadian tree company. I forgot what it was. I  
4 think it took about four weeks to process the  
5 event and there was complete panic. And everybody  
6 said, God, thank God it wasn't General Motors.  
7 General Motors was a two-day event.

8 MR. MOONEY: If I could --

9 MR. RAMSAY: Go ahead.

10 MR. MOONEY: If I could just ask a quick  
11 follow up. Can I get your thoughts on sort of  
12 interoperability among CCPs and among market  
13 infrastructures?

14 MS. TAYLOR: I think interoperability is  
15 a question that gets a lot of play. I think that  
16 there possibly are places where it is -- I think  
17 it depends on how you define it and depending on  
18 how you define it there probably are places where  
19 it is relevant. I think it is important for, for  
20 example, CCPs to be able to interact with the  
21 Trade Information Warehouse. I do think that one  
22 of the things that I have failed to point out so

1 far during that part of the discussion is that  
2 different clearing services are structured in  
3 different ways so they actually need to interact  
4 somewhat differently with the warehouse. The  
5 question that you were raising, Steve, about the  
6 difference between the open position shown in the  
7 warehouse and the open position shown in clearing,  
8 in the case of our clearing service for credit,  
9 the trades no longer exist in the warehouse once  
10 they have been cleared. And so the relevant piece  
11 of information to be put into the warehouse as a  
12 result of our clearing service for credit would be  
13 the net position that you have left. And so there  
14 wouldn't be a difference between the kind of  
15 cleared open exposure and the warehouse open  
16 exposure if people are reporting it based on the  
17 net open position.

18 So I think that there are some cases  
19 where entities need to be able to interconnect. I  
20 think interoperability as a matter between  
21 clearinghouses is something that is more complex.  
22 That brings with it credit risk between CCPs and

1 interdependence on the risk management regimes of  
2 different CCPs where there can be differences in  
3 the way that services are constructed. There can  
4 be differences in the way that margins are  
5 calculated. There can be differences in the  
6 balance between margins and the guaranty fund  
7 process. And done inappropriately the  
8 interoperability between CCPs can actually create  
9 more systemic risk rather than helping to reduce  
10 systemic risk which is really the goal of the  
11 clearing service.

12 MR. HARRINGTON: From a client  
13 experience standpoint, one thing that we've seen,  
14 especially in CS working with both -- with Kim and  
15 Chris at CME and ICE for our end-users is the  
16 functionality in the clearing systems and, you  
17 know, all of the, you know, margin requirements  
18 that the CCPs mandate, that's obviously their  
19 business and they obviously compete in that space.  
20 But from a -- from the actual ability to reach the  
21 clearing destination I think the interoperability  
22 is very good, mainly in the fact that, you know,

1 when a client decides they want to clear at CME or  
2 ICE, we're able to give them direct access to both  
3 clearinghouses. They're able to see, you know, in  
4 an almost real-time format, you know, the status  
5 of their trade from execution to DCM acceptance to  
6 the ultimate clearing of the trade happen. And  
7 the actual experience is very much the same. So  
8 obviously there's going to be competition on the  
9 merits and that's a good thing, but I think that  
10 the final result is a very fair and very good  
11 outcome.

12 MR. EDMONDS: I would agree with the  
13 comments that Kim made on the complexity of if  
14 you're talking about CCP to CCP interoperability.  
15 I mean, fundamentally, before we even get into the  
16 technical merits of that, and I'm not sure that  
17 this is the place to do that, but philosophically,  
18 I mean, Dodd-Frank was very clear that we should  
19 move as many of these OTC products into a world  
20 that we had become accustomed to and the safety  
21 and soundness of -- we'll call it the FCM futures  
22 model, whatever you want to -- it's not exactly --

1 one size clearing isn't going to fit all. And we  
2 talked a little bit in the earlier morning session  
3 around some of the challenges around that.

4 But before we even get there we're going  
5 to start having an experiment in top down market  
6 design. It seems incredibly dangerous. I mean,  
7 legislation asks us to go one place. We're now  
8 mandated to go there. The regulator's job is to  
9 provide us some rules of the road of how to get  
10 there. And before we get there we're going to  
11 think about going in other directions and  
12 expanding the scope of that. And from my  
13 perspective I think it's an incredibly dangerous  
14 track to go down.

15 MR. DIPLAS: I think that, I'm sorry, I  
16 think that at the current state of clearing the  
17 probability is not feasible to the extent that --  
18 I'm talking about derivatives interoperability.  
19 I'm not talking about cash. I think that can be  
20 done in cash.

21 On the CDS side, right now to the extent  
22 that we have CCPs that have different membership

1 requirements, different risk frameworks, sometimes  
2 even different actually underlying instrument, it  
3 is very difficult to think -- and when I'm talking  
4 about interoperability, I'm talking about the full  
5 interoperability that says Tom and I trade, he  
6 decides to go to CME, I decide to go to ICE. That  
7 is like playing a football game. He goes to  
8 stadium A and I go to stadium B right now. We  
9 cannot meet. So it doesn't work at this stage of  
10 clearing.

11 In the future, perhaps if we can do  
12 that, that's fine. But I would agree with Chris  
13 that I think our number one priority is actually  
14 first get the trades into clearing, get some  
15 confidence that actually we can do this correctly,  
16 and then we can worry about whether we can  
17 actually achieve the interoperability or not.

18 MR. PIRRONG: Yeah, from an economist's  
19 perspective, I mean, there are tremendous  
20 economies in scale and scope in this business,  
21 whether it's due to netting, diversification  
22 effects, and so on. So I think that there is

1 going to be a tendency from migration to a single  
2 clearinghouse or a small number of clearinghouses.  
3 How that migration takes place will in part depend  
4 on if there is mandated interlinkage between them.  
5 But the one caution that I would make is that, you  
6 know, we sort of had mandated interlinkage in the  
7 equity market for example and we saw that under  
8 times of stress, like on May 6th, that that's when  
9 those linkages break down. Well, the whole point  
10 about clearing is to basically deal with those  
11 stress situations. So I think you have to tread  
12 very carefully with looking at interoperability  
13 and particularly mandated interoperability in  
14 clearing.

15 MR. RADHAKRISHNAN: Let me ask a  
16 question about competition. I think while there  
17 may be very healthy aspects of competition, it's  
18 also possible that there may be unhealthy aspects  
19 of competition, specifically CCPs competing on  
20 margin in a race to the bottom. So what  
21 suggestions do people have for the regulators to  
22 make sure that this doesn't happen? Should we,

1 for example, I'm not suggesting it but should the  
2 regulators mandate a particular margining  
3 methodology that all CCPs have to use for credit.

4 MS. JOHNSON: Could I hope in there?

5 Ananda, if I may, I'm sorry. I think this  
6 question is tremendously well linked to Kim's  
7 comment earlier about systemic risk. And to the  
8 earlier comments in the morning session about a  
9 race to the bottom. In an earlier comment I noted  
10 that, you know, each of the CCPs is an independent  
11 business competing on its own merits and  
12 developing its own proprietary practice models and  
13 practices for risk management. If there --  
14 whether it's clear that Dodd-Frank mandates  
15 clearing of all or how we define all eligible CDSs  
16 or requires the bringing in of as many things as  
17 possible, I think one point not to miss and that  
18 is more obvious than all of those is that the  
19 systemic risk that arises from some negative  
20 aspects of competition, the negative externalities  
21 that can arise in the business should not be  
22 overlooked. And there's a place where I think

1 there is a tremendous opportunity for the  
2 regulators to act innovatively in that while it is  
3 the case that each CCP is its own business and  
4 will develop its own models and practices, there  
5 has to be for normative reasons a threshold  
6 beneath which no competitor is allowed to sink.  
7 And the purposes there are to ensure that all the  
8 benefits of the multilateral netting are captured  
9 without bringing into the picture the negative  
10 externalities that will certainly arise from not  
11 -- ineffective pricing or risk management  
12 practices.

13 MR. BENISON: So, if I can, I think  
14 there's a couple of things to think about. I  
15 don't think it makes sense to say we're going to  
16 mandate that you all use the same margining  
17 process. I think if you do that you potentially  
18 lose the benefits of innovation, you lose the  
19 benefits of having different people looking at the  
20 same problem and coming up with a different  
21 answer. And there may be different reasons why  
22 one CCP decides to margin differently from

1 another.

2           One of the questions that also comes  
3 into that is not just margining but how do I break  
4 between the IM and the guaranty fund? And how do  
5 I break between what's funded in the guarantee  
6 fund and what assessments rights are and how much  
7 that is? So I think it's more important to ensure  
8 that there's transparency as to what standards  
9 each CCP is using; that there's enough enforcement  
10 to ensure that CCPs are in fact meeting the  
11 standards that they have set for themselves; and  
12 three, ensuring that to the extent you've got  
13 reliance upon assessment rights that you can  
14 reasonably expect that your nondefaulting members  
15 will have the liquidity to pay those assessments,  
16 you know, in a timely fashion when you have the  
17 default of another member.

18           MR. RAMSAY: I was going to ask a  
19 related question which is obviously there has to  
20 be some ability on -- presumably there has to be  
21 some ability on the part of clearinghouses to  
22 innovate, play their own methodology. What

1 happens in a situation where, you know, leaving  
2 aside questions about valuation, if you had very  
3 similar products traded on more than one  
4 clearinghouse, in the event that just the amount  
5 of margin collected is significantly different in  
6 one case than the other, what would that say? If  
7 anything, what would it say from a regulator  
8 perspective? Would it suggest that -- should that  
9 raise questions? Alarm bells? Should one assume  
10 that if people are, you know, following good  
11 prudent risk management purposes that those ought  
12 to be fairly similar?

13 MR. TURBEVILLE: That has happened. And  
14 I think one exercise that might be helpful is to  
15 go back and look at times when that's occurred in  
16 various products and to try to determine what's  
17 going on. I think the motivations now might be  
18 different from where they were prior to 2008, but  
19 there's no doubt that competition among  
20 clearinghouses, it's a relatively new phenomenon.  
21 And there's no question that one issue, one cost  
22 factor is margin and one cost factor is

1 correlations. It's a deep question that is worth  
2 thinking about. But I think one thing we know now  
3 is that the level of activism to understand what's  
4 going on by the regulators and the level of  
5 expertise in understanding how those numbers work,  
6 there's a need for a greater focus on that,  
7 especially as clearing becomes such a central  
8 feature in the financial system.

9 MR. GOOCH: I think one thing to think  
10 about is you do get those anomalies from time to  
11 time. And I think, you know, we talk a little  
12 about competition and multiple clearinghouses  
13 clearing the same product. But I think we need to  
14 be very careful we do have genuine competition.  
15 If you think about CCP, they're trying to set  
16 margin levels. And how do they go and  
17 commercially win the next trade to be cleared?  
18 And how do they risk manage the existing trades?

19 The next trade for the individual user  
20 is more driven by correlation, the impact on the  
21 default fund contribution, a lot of factors other  
22 than just the margin go into that decision to put

1 a trade into an existing clearinghouse. I think  
2 if you want to have competition on margin that was  
3 more generally, interoperability probably isn't  
4 practical. I think we've been struggling in the  
5 cash markets to make it work. Maybe in 10 years  
6 time we can also come back here again and have a  
7 debate about OTC interoperability but we're  
8 probably not going to get there at the moment.  
9 But giving people the ability to move trades  
10 between clearinghouses I think is quite important.  
11 If you pick a clearinghouse today, if you leave  
12 that trade for two years, if you and your  
13 counterpart agree, you might want to move those  
14 positions. You should be able to do that and that  
15 would I think in itself create enough competition  
16 to iron out some but not all of these anomalies on  
17 margin. Otherwise, in practice it's going to --  
18 market pressure to fix some of these things.

19 MS. MARTIN: To talk --

20 MS. TAYLOR: Oh, go ahead.

21 MS. MARTIN: Just to touch on a couple  
22 of points. I agree with a lot of what my

1 co-panelists have said. But to go back to  
2 something Mike said earlier in the earlier session  
3 this morning, it comes down to the analysis  
4 process that you force a DCO applicant to undergo  
5 while they're going through the application  
6 process. And the in-depth of that analysis  
7 process is very similar to what you have been  
8 undergoing with your portfolio clearing. But in  
9 our view it's not just a process that ends when a  
10 DCO gains its license. It's a process. It's a  
11 continuing process that -- where the DCO should  
12 have to review its risk management capabilities,  
13 its risk management functionality with the  
14 different regulatory agencies throughout the  
15 lifecycle of its clearing.

16 MS. TAYLOR: With respect to kind of  
17 answering your question about whether there could  
18 be legitimate reasons why margins would be  
19 different at two different clearinghouses looking  
20 at the same product without something being wrong  
21 with that, I would just offer a couple of points  
22 of consideration. One is that there are some kind

1 of basic statistical tests that clearinghouses  
2 undergo in evaluating margining, and there are  
3 basic coverage standards. Tom talked about this a  
4 little bit. Standards that the clearinghouses set  
5 for themselves to be able to cover. I think one  
6 thing that would be important from the regulatory  
7 point of view is to be able to monitor whether  
8 clearinghouses are actually adhering to the  
9 standards that they've set for themselves.

10 But I think it is not unreasonable for  
11 clearinghouses to set somewhat different standards  
12 for different products for the same product set  
13 given different environments that they might be  
14 operating in. They might be operating in a  
15 situation where they have more clearing members  
16 contributing to the pricing and the default  
17 management, therefore, the liquidity that they  
18 would face would be better than the liquidity  
19 another clearinghouse might face. That's one  
20 example. They might be sitting on a book of  
21 positions that is very diversified across and kind  
22 of evenly spread among market participants, a

1 large number of market participants, or another  
2 clearinghouse might be sitting on a book of  
3 exposure that is more concentrated that would  
4 affect the level to which they do margining.

5 They also could be making a slightly  
6 different choice about the mix of resources that  
7 they want to bring to bear in a situation of a  
8 default. The waterfall could be leaning more  
9 toward margin, could be leaning more towards the  
10 guaranty fund, and both of those are very  
11 legitimate choices as long as the ultimate outcome  
12 is that the clearinghouse provides for the ability  
13 to withstand the default of the x-number of market  
14 participants that is determined to be the target  
15 there. So I think there is definitely room for  
16 legitimately different decisions to be taken in  
17 looking at the margining for the same product.

18 MR. BODSON: I think --

19 MR. DIPLAS: I would agree.

20 MR. BODSON: Sorry, the CPS IOSCA  
21 standards for clearinghouses, settlement systems,  
22 or payment systems are out there that everybody

1 should be subject to. You know, the point, if  
2 there are differences the question should be, of  
3 course you should question it. And there could be  
4 very legitimate reasons or there could be very,  
5 you know, not so legitimate reasons. But that's  
6 the role of the regulators. But it's also the  
7 role of the market participants. There are  
8 offerings out there where people have said I'm not  
9 going to go near those guys because it's way too  
10 much risk. It's not always about, believe it or  
11 not, Wall Street is not always about money and  
12 trying to find the cheapest trade to do or, you  
13 know, maximize the profit. We do, as I said  
14 before, we do want to survive. And if somebody is  
15 going to take -- have you come in into a risky  
16 situation everybody will pass. When we started  
17 Euro CCP, the one thing we heard all the time, we  
18 have very high membership requirements, this is  
19 our European KAS CCP, was you're charging me --  
20 your requirements are way too high on me but make  
21 sure you get that guy because he's really weak.  
22 Okay? We all love each other except when it comes

1 to trusting each other.

2 MR. DIPLAS: I agree with Kim's comments  
3 in terms of that the CCPs can have some  
4 flexibility. And I agree that the books might  
5 look different and they should have that  
6 flexibility. The regulars have to make sure that  
7 fundamental assumptions though are consistent. I  
8 think to me that's the most important element.  
9 Having one CCP assume that they can actually  
10 withstand one significant member default, have  
11 another sustain three members default is not a  
12 good situation. I mean, people vote obviously  
13 sometimes with their wallet, sometimes they vote  
14 for risk reasons like I said, and obviously we're  
15 going to make these decisions. And sometimes  
16 clearing members might not have the full picture  
17 and the regulars have that full picture. The  
18 underlying framework assumptions that Tom alluded  
19 to, assessment rights. Is the CCP there? Does it  
20 have -- if you put a dollar in the guaranty fund,  
21 are you assessed a second dollar and then it is  
22 game over? Are you assessed multiple dollars?

1 That is a fundamental assumption. And that is  
2 what's going to have the most systemic risk impact  
3 than anything else. Some of the small stuff,  
4 micromanaging the margin whether it's 1.9 or 2  
5 percent, I think we can live with that.

6 MR. RAMSAY: But even in terms of the  
7 general standards there may be some play there. I  
8 mean, there's the international standards Mike was  
9 mentioning, you know, in the views of some are  
10 probably too lenient. There should be, you know,  
11 stricter than being able to handle the defaultable  
12 largest one. So it's -- it will be a struggle  
13 from the regulatory standpoint to figure out where  
14 the baseline is.

15 MR. RADHAKRISHNAN: Let me ask a  
16 question about the specific risks of CDS. There  
17 is this notion of a jump to default and there's  
18 also a notion of a jump from default. So the  
19 question is currently the clearinghouses that  
20 offer clearing procedures, what additional  
21 considerations have you put into your risk  
22 management systems to take into account the

1 specific risks of CDS? And once you hear from the  
2 CCPs, the others will point to other things that  
3 people should think about.

4 I don't mean to put people on the spot  
5 but I am going to put people on the spot.

6 (Laughter)

7 MR. IVANOV: Indeed, fundamentally the  
8 risk of the CDS instruments is quite unique and is  
9 quite skewed towards protection sellers mainly  
10 from jump to default. So ICE specifically will  
11 look at many different types of risks associated  
12 with CDS products. The first one is the so-  
13 called spread dynamics, namely how the spreads are  
14 moving upon extreme conditions without even  
15 entering an explicit state of default. That would  
16 be the first factor.

17 The second one would be liquidity risk,  
18 you know, liquidity requirements that should be  
19 assigned for different instruments. Definitely,  
20 as we discussed in the previous session, different  
21 instruments. They have different market activity,  
22 different liquidity upon extreme conditions

1 definitely the bid offer could substantially  
2 widen. As a result we have models and we have  
3 ways to estimate the liquidity charges associated  
4 with liquidating big portfolios because we have to  
5 all remember that the current settlement levels,  
6 they correspond to eventual mid- level that should  
7 be very accurate. And it's used as a base point,  
8 reference point, for looking at the margin  
9 requirements and how they perform.

10 The next type of risk that we'll look at  
11 is concentration charges. We have very  
12 specifically designed concentration charges that  
13 approach the maximum liability as the positions  
14 increase. For example, from a protection seller  
15 point of view the overall margin requirement could  
16 approach the total notional on which protection  
17 has been sold. And if you're a protection buyer,  
18 then the requirement could be the full coupon  
19 payment, the forward payments. Of course, we  
20 mentioned the jump to default. We have specific  
21 sensitivity analysis associated with assumptions  
22 about the recovery rates. Typically, we'll look

1 at jump to default in terms of minimum recovery  
2 rate, which is name specific, sector specific to  
3 reflect the overall risk of these instruments. We  
4 look at interest rate sensitivity in terms of what  
5 would happen if the spread market performs in the  
6 same way but there is all of a sudden significant  
7 move of the default-free interest rate.

8           So the final requirement is a  
9 combination of five different risk elements and we  
10 attempt to quantify very carefully each of these  
11 elements and build the total margin requirement,  
12 which would reflect all types of -- or practically  
13 five different elements of risk associated with  
14 those instruments.

15           MS. TAYLOR: We have a not dissimilar  
16 approach theoretically. We have a seven factor  
17 model that looks at a variety of different sets of  
18 market conditions. In many of those factors the  
19 margins automatically scale as the spread on the  
20 product increases. But then there are also  
21 specific liquidity considerations and specific  
22 jump to default. One of the factors is a jump to

1 default or jump to worse credit type of  
2 evaluation. And then there's also an element in  
3 our minimum margin that considers the margin that  
4 is calculated based on looking at the portfolio  
5 and all of the different factors as well as  
6 looking at the jump to default risk. And then  
7 that could trigger a minimum.

8 MR. GRAULICH: So we have also developed  
9 a model which funnels the specifics of credit  
10 default swap. And in particular, the asymmetric  
11 risk profile of the protection seller and the  
12 protection buyer. So, for example, the protection  
13 seller has to post a special margin which we call  
14 a credit event margin which is oriented or  
15 calculated based on the largest exposure within a  
16 portfolio with regards to individual names. So we  
17 assume that if the biggest name in the portfolio  
18 defaults, then we assume a recovery rate of zero  
19 and the second name with a recovery rate of 40.  
20 So that reflects the credit event element and on  
21 the other hand the protection seller, of course,  
22 has the risk or carries the risk of the crude

1 premium margin. So it is also separately  
2 margined. So to characterize or reflect the  
3 characteristics of this asymmetric risk profile  
4 between protection seller and protection buyer is  
5 reflected in our margining methodology.

6 MR. CURLEY: Can I just ask? Maybe just  
7 to provide some context for those three  
8 descriptions, can you give a sense of how your  
9 models have changed over a period of time? What  
10 have you learned from the process of introducing  
11 the clearing of these products? And what areas  
12 are you still thinking about, either in comparison  
13 to the, you know, other platforms in your own  
14 modeling that are issues you expect to face in the  
15 near future?

16 MR. GRAULICH: I think, if I may  
17 continue, I think the margin methodology is only  
18 the way to make sure that in a default scenario  
19 you have sufficient margin. What is ultimately  
20 important is that this model is strong against  
21 stress testing. So if you do stress testing,  
22 testing your margin methodology against what can

1     happen, and that is from my perspective the  
2     ultimate way to make sure that there is a  
3     consistent methodology or consistent approach to a  
4     wide race to bottom on the margining side between  
5     clearinghouses that all clearinghouses have to  
6     ensure that, for example, they are compliant with  
7     a 99 percent -- 99.9 percent confidence level with  
8     their margin requirement and their clearing fund.

9             And I think what the regulator could do  
10    is to define those stress tests with some more  
11    detail to avoid this race to the bottom because  
12    there are many assumptions in those stress tests  
13    which ultimately make you comply or not comply  
14    with regards to the margin requirement. I think  
15    the margin -- the margin methodology itself should  
16    stay with the clearinghouse because the more  
17    sophisticated you are on the methodology side, the  
18    more you are aligning yourself with the curve of  
19    the stress test which then is efficient or brings  
20    efficiency to the market. So I think the  
21    regulatory side should focus on the stress testing  
22    of the portfolios or the margin methodology.

1           MR. IVANOV: Yeah. I would completely  
2 agree with Matthias that the main thing is there  
3 should be some flexibility in terms of how the  
4 guaranty fund and the margin requirements are set,  
5 but the ultimate test should be what is the stress  
6 test scenario or set of scenarios that we want to  
7 be protected against and extending the discussion  
8 I would say that for example, at ICE we look at  
9 two simultaneous defaults of the two biggest  
10 losers upon extreme conditions and then assuming  
11 the three single names in those portfolios in  
12 which they wrote protection would be defaulting at  
13 the same time. So overall, the stress test  
14 scenario used to determine the size of the  
15 guaranty fund would correspond up to eight  
16 simultaneous defaults which is a very extreme type  
17 of realization along with additional widening and  
18 tightening.

19           In terms of definite skew of the risk  
20 profile, the margin requirements at ICE, for  
21 example, they're about three to one, even more  
22 skewed toward protection sellers which are the

1 main sources of systemic risk. In terms of  
2 evolution of the systems and the models, the main  
3 thing that we're focused on currently is how we  
4 account for basis risk and how we provide a single  
5 name versus index benefits in an efficient way  
6 without making it prohibitively expensive to  
7 maintain a flat risk profile. Because on the  
8 other hand, if we don't have the proper portfolio  
9 margining, then it disincentivizes the clearing  
10 participants and overall clients of the  
11 clearinghouse to maintain a flat risk profile  
12 which would be the ultimate goal because the  
13 clearinghouse when deals with less actively traded  
14 instruments, would be able to more easily unwind  
15 such portfolios upon auction.

16 MR. RAMSAY: At the risk of getting a  
17 little heavily into the weeds on this, and if  
18 there's a lot of stress being put on stress  
19 testing as something that can provide comfort, is  
20 it presumably the meaning of extreme and  
21 conditions could be different -- viewed  
22 differently across different firms. How much from

1 a regulatory perspective can practically or should  
2 the regulators try to make sure that those things  
3 are defined similarly, I mean, in term of it can  
4 be different depending on sort of the historical  
5 horizon you're looking at, the number of kinds of  
6 factors you're looking at, the number of factors.  
7 How should we look at that from a regulatory  
8 standpoint if anyone wants to?

9 MR. EDMONDS: I mean, I think in some  
10 respects there are examples of previous behavior  
11 where that stance has already been taken where,  
12 you know, either through launches of new products  
13 or the certification products of new products and  
14 things of that nature where regulators, CFTC  
15 specifically and SEC as well, you know, have asked  
16 how certain assumptions being made around the  
17 management of these instruments would have behaved  
18 during historical points of reference, be it  
19 Lehman or some other high-water mark that's out  
20 there that we want to make sure that's cared for.

21 So, you know, I would offer that you're  
22 on the right trail with that. You've got to get

1 to a level of comfort that you're asking the right  
2 questions around that but, I mean, those are the  
3 only, I mean, can we solve things that we don't  
4 know? I mean, we're going to use a historical  
5 reference point to get there and say we're better  
6 than it was before. We've learned, we've made  
7 improvements, the process has given us now a  
8 better market in which to operate. So I don't  
9 know how else you would get to that point. Now,  
10 it would be up to you to make a determination as  
11 the regulator whether or not the answer you got  
12 was sufficient but, you know, certainly those are  
13 the questions.

14 MR. DIPLAS: I could give you a couple  
15 of things that we haven't experienced yet but I  
16 think it's something that you might want to  
17 consider going forward. For one, I think it's  
18 clear that if you compare CDS versus other asset  
19 classes, it clearly requires a longer unwind  
20 horizon. So talking you might need a few hours of  
21 the day for Euro dollar futures but you need  
22 probably a week or two for CDS. And depending

1 again what we're looking at that.

2           The second thing that is actually  
3 unique, we haven't done that yet, is correlating  
4 sequential default, which is especially as we get  
5 into client clearing, I think you're going to have  
6 to worry about a situation that a large client  
7 default, the FCM, and again it goes back to  
8 membership requirements on the staff is unable to  
9 handle that client default. And if it defaults  
10 itself, that actually increases the CDS trading,  
11 increases the values for everybody else. And then  
12 you have to worry about how to do the unwind.  
13 Okay? That is something again that we haven't  
14 experienced but this has to be on the radar.

15           And then lastly, there has to be  
16 consistency in terms of decision-making. It goes  
17 back to what we mentioned earlier about the  
18 determination committee. There are events that  
19 have to be --

20           MR. RADHAKRISHNAN: So Athanassios,  
21 you're saying both the client and the firm are  
22 names?

1 MR. DIPLAS: Well, that is -- yes.

2 MR. RADHAKRISHNAN: Okay.

3 MR. DIPLAS: Well, one or the other. I  
4 mean, that would be a scenario but obviously, I  
5 mean, I'm giving you the worst case scenario.  
6 Right? I mean, but either way you have to worry  
7 about the client -- first of all, the FCM being  
8 able to handle the portfolio because if they  
9 don't, then they default and then we have to  
10 basically figure out what to do with their  
11 portfolio.

12 And the last thing, the determination  
13 committee consistency. You need to ensure first  
14 of all that, you know, when we say -- in general,  
15 we tend -- most market participants, at least the  
16 clearing members which we care about in terms of  
17 managing their default, they tend to run pretty  
18 small net books but very large gross books. So  
19 you want to ensure that there's consistency  
20 obviously in terms of the treatment of these  
21 trades and you don't want to have a situation that  
22 CCPA says GM defaulted; the CCPB says it didn't

1 default. Okay? In that scenario, right now the  
2 current CCPs obviously are aligned in that respect  
3 but you want to ensure that if a new one comes up  
4 they don't have the option to say I won't listen  
5 to what the determination committee says; I'll do  
6 my own thing. Because also remember as the  
7 default happens, clients will be moving positions  
8 from FCMA to FCMB or potentially from CCPA to  
9 CCPB. And you need to ensure that those things  
10 are going to move smoothly. So these are things  
11 that have to be on the radar and again, as I said,  
12 the new things, we haven't dealt with them before  
13 but we have to think about them.

14 MR. RAMSAY: And how as a practical  
15 matter does one do that from a regulatory  
16 perspective? I mean, is it enough to sort of make  
17 sure that the sort of machinery or the type of  
18 process that's in place in terms of determination  
19 committees and making those decisions is roughly  
20 the same across clearing agencies?

21 MR. DIPLAS: Well, the next committee  
22 one would be easy. There would have to be a

1 commitment, absolute commitment from the CCPs.  
2 They will abide by these decisions like any other  
3 member of the trade. It is written in the rules  
4 and it is written in the contract. And then there  
5 is actually no optionality. That makes life  
6 easier. Some of the other stuff I described  
7 actually is much more complex. At least that one  
8 is the easy one. We can say -- we can rule that  
9 that is the case.

10 MR. BENISON: So just to be clear on  
11 that, so the ISDA determinations committee, under  
12 the contracts, you know, as part of the changes,  
13 you know, CDSs have been standardized, I keep  
14 saying this, for 10 years. We've made some  
15 changes to those standards. One of those changes  
16 was to move to -- move from bilateral agreement as  
17 to things like successor events and credit events  
18 to the ISDA DC as the place to make those  
19 determinations. So there's a determinations  
20 committee with representation for the buy side,  
21 sell side, that turns over over time where the  
22 decision is made. And so I think what Athanassios

1 is talking about is having that determination  
2 committee be recognized as opposed to separate  
3 determination committees that might all reasonably  
4 look at the same situation and potentially come to  
5 a different answer.

6 MR. RAMSAY: So that would presuppose --  
7 I'm not suggesting it's inappropriate --  
8 presuppose this regulatory matter that we're in  
9 essence looking to a private sector sort of  
10 organization for making those determinations  
11 suggesting a clearinghouse. It should reference  
12 those in each case.

13 MR. BENISON: Yeah, I think so. But I  
14 mean, if each clearinghouse has its own those are  
15 private sectors at this point anyway.

16 MR. RAMSAY: Right.

17 MR. DIPLAS: Plus, we have gone now  
18 through about, whatever, six or seven credit  
19 events and that has actually -- one thing we can  
20 say about the crisis, one thing that worked well,  
21 that was it.

22 MS. JOHNSON: But there are real sort of

1 legal concerns with looking to ISDA as the  
2 determining body for these issues. While I think  
3 there are obviously economic efficiencies in  
4 certain operational benefits for having the  
5 determinations committee of ISDA make the  
6 decisions for the industry and so that there are  
7 not sort of competing interpretations of what's  
8 happening, for the regulators the reliance on ISDA  
9 is politically less easy or even legally less  
10 facile in part because ISDA is an independent non-  
11 governmental agency that doesn't have immediate  
12 accountability to a federal agency or a particular  
13 standing under any sort of specific jurisdictional  
14 rules. And the mini jurisdictions where ISDA's  
15 sort of policies certainly sort of direct the  
16 market. So there is sort of a gap there in taking  
17 that step that is something for the agencies to  
18 look at very carefully.

19 MS. JOSEPHSON: Picking up on that  
20 point, we've been focusing on the product  
21 documentation to some extent and the  
22 determinations committee around credit events, but

1 I was wanting to solicit the group's views on the  
2 relationships between the clearinghouses members  
3 and customers in terms of documentation. The sort  
4 of master agreements but also client arrangements,  
5 give up arrangements, and ideas about how those  
6 documentation issues could be addressed with the  
7 overarching concern about access to clearinghouses  
8 for customers, the client clearing initiatives  
9 that have been underway.

10 MR. CAWLEY: Let me jump in. I think a  
11 good place to start when you look at clear product  
12 is to look at where the other cleared product is  
13 in the listed derivative space. So, you know,  
14 there is precedent for clearing agreements and  
15 for, you know, give up agreements that various  
16 bodies have put together, you know, from the list  
17 of derivatives experience and they're pretty good.  
18 And they're pretty simple. They're pretty  
19 symmetrical. You know, one of the things that  
20 we're looking at is the current execution, give up  
21 agreements that are in place there to draw -- to  
22 draw that experience from.

1           We should be mindful that the agreements  
2 shouldn't be overly complex and should just really  
3 deal with the facts and the issues themselves.  
4 Standard clearing agreements, again, it's a good  
5 place to draw from is from the list of derivative  
6 space.

7           MR. EDMONDS: I would add that, you  
8 know, prior to the legislation, right, the world  
9 was much more gray. And it leads to the  
10 documentation that we employed at ICE Trust was  
11 one, to remove that gray area. And we did that in  
12 terms of a standard terms annex. Now that we have  
13 legislation and with the implementation of the  
14 rules of that legislation, and there will be  
15 opportunities for us to move with much more legal  
16 certainty than existed prior, to a more  
17 standardized documentation that is consistent with  
18 the FCM or agency-based model that in our opinion,  
19 based on the regulatory construction which we  
20 operate, were not available to us. And introduced  
21 more confusion than it was worth at that point in  
22 time.

1           Certainly, those standard agreements  
2   that Jamie makes reference to in that they've been  
3   negotiated between clearing members and their  
4   customers for their entire existence and they've  
5   become form like in some respects and they've  
6   moved along to serve a very specified purpose.  
7   There is still a bilateral nature in those  
8   agreements of what the clearing member and the  
9   risk around the clearing member is willing to  
10   accept on behalf of those individuals. That's not  
11   necessarily a CCP issue. Our issue is to make  
12   certain that our rules govern the product and the  
13   behavior of the participant in a consistent  
14   manner. And we're certainly moving the transition  
15   to that new documentation that's now for the first  
16   time available to us under this.

17           MR. GOOCH: I think --

18           MS. TAYLOR: We brought our service to  
19   market under the FCM model originally and so the  
20   documentation process I think was much simpler  
21   than the documentation process that needed to be  
22   followed in some of the other cases. There was an

1 annex to the futures agreement. I would expect  
2 that that's going to be the way that things will  
3 move forward under the new legislation and  
4 regulation.

5 I would like to say one thing about the  
6 give up agreement though. I think there  
7 definitely is a time and place for there to be a  
8 complete industry standard around certain things.  
9 I would say the determinations committee is a good  
10 example of that where you don't want necessarily  
11 different outcomes from the same set of facts  
12 about whether there's a credit event or not. But  
13 with respect to things like the give up agreement,  
14 I think that there is -- I think there's a  
15 tendency by the industry that has long been a ISDA  
16 governed consensus based process that they don't  
17 do anything differently unless everybody agrees.  
18 And the -- in the case of the give up processing,  
19 it is an operational process. It's a credit  
20 process. It's a part of the service that is an  
21 example of something that could be innovated on by  
22 one or more CCPs in slightly different ways to

1 provide an efficiency to the market participants.  
2 And having a process that says that type of thing  
3 has to be governed by an agreement that everybody  
4 has to agree to before anybody can innovate is  
5 probably going to stifle the ability of the  
6 marketplace to respond to changes in market  
7 conditions and provide innovative services.

8 MR. BENISON: One thing I would say, and  
9 I don't think we have much in the way of end-user  
10 representation here, but I think, you know, from  
11 an end-user perspective as we've gone through and  
12 from all the dealers at Southside, we've all  
13 negotiations bilaterally with clients, working  
14 with multiple clearinghouses in working groups  
15 with end-users and what these agreements should  
16 look like, and I think one of the things we found  
17 out is that as clients are going over the detail  
18 of the existing futures agreements, they're  
19 starting to see things where they say, well, you  
20 know what, I don't really like that. I kind of  
21 want to change that. I want to change the way  
22 that works. And I think, you know, as a whole, as

1 we've gone back and said, look, we need to take  
2 derivatives -- derivatives are a 15, 20 year old  
3 product. We need to modernize them. We need to  
4 make them safer so we're going to put them into  
5 clearing.

6 We also need to look at clearing and  
7 realize that clearing hasn't changed that much in  
8 a longer period than derivatives have been around.  
9 And so from the perspective of the OTC swaps  
10 market, people are very used to be very  
11 documentation intensive and going through and  
12 looking at all this. And as people went through  
13 and started looking at clearing, we found that  
14 we've had to make a lot of changes and a lot of  
15 those we've worked with the clearinghouses on and  
16 elsewhere. And so that's still ongoing. And from  
17 an end-user perspective they're still looking at  
18 those issues as well. So I think it's important  
19 to remember that, you know, we need to move the  
20 documentation along but we need to take into  
21 account all of the relationships and ensuring that  
22 as we move swaps, you know, we take swaps which

1 haven't been in clearing and we put them into  
2 clearing that was originally developed for  
3 products that are very different that we're sure  
4 we make the changes that are appropriate for that.

5 MR. RADHAKRISHNAN: Could a possible  
6 solution be for the regulatory agencies to  
7 prescribe documentation if there is no consensus  
8 and if you assume that you want to get to, you  
9 know, a state of affairs which is clearing by a  
10 particular time. And if you leave it up to the  
11 market participants and nothing happens, should we  
12 prescribe something?

13 MR. EDMONDS: But to Kim's point that  
14 she made a little bit earlier, I mean, part of the  
15 function in that documentation relates to a number  
16 of different bits and pieces between the  
17 relationship, credit being one of them, that's  
18 being extended by the clearing member to the end  
19 user. So while you might be able, as a regulatory  
20 authority to assign certain minimums that  
21 documentation must include, being overly  
22 prescriptive of that, I'm not sure you're ready to

1 wear that risk.

2 MR. DIPLAS: I think the industry is  
3 already incentivized to actually get this done  
4 quickly, both by certain cell side. And I think  
5 again we're all incentivized to ensure that we  
6 define the most -- the common things that we can  
7 put in a document that they can apply to everyone  
8 because that makes for a simple document. And  
9 obviously to the extent we still manage a  
10 bilateral relation, we still need to maintain that  
11 flexibility to manage that. So I think that is  
12 something people are spending a lot of time both  
13 -- and also with trade associations to actually  
14 get that done. So I agree with Kim's comments  
15 obviously that, you know, sometimes we take too  
16 long. It's like herding cats. But we'll kind of  
17 get there.

18 MR. RADHAKRISHNAN: Speaking of  
19 incentives and disincentives, both the SEC and the  
20 CFTC have the responsibility to set margin  
21 requirements on those entities that will register  
22 with us as dealers and who are not regulated by

1 the prudential regulators, i.e., the banking  
2 regulators. So how should we do this? On the one  
3 hand -- (Laughter) I'll come out and ask. It's  
4 been on my mind for a long time.

5 MR. RAMSAY: You each get two minutes.

6 MR. RADHAKRISHNAN: How should we do  
7 this? And the considerations are, one, you want  
8 to make sure that there are incentives to clear.  
9 Right? Number two, at the same time I guess there  
10 would be some products that just cannot be cleared  
11 and will remain bilateral. And what is a balance?  
12 You don't want to be punitive. So, and I guess  
13 the question can be asked on different product  
14 classes but specifically with respect to CDS. How  
15 should we do this?

16 MR. DIPLAS: But you are right in saying  
17 incentives. First of all, let's look at the  
18 current state. We have tremendous incentives to  
19 clear. If I face a counterparty bilaterally  
20 versus actually having the same trade in the CCP,  
21 I get a tremendous benefit in terms of the capital  
22 that I have set aside. So that incentive is

1     there.  The part I would sorry sometimes is when  
2     people use the word incentives if they say that  
3     the risk is X, capital should be 3X instead of X.  
4     Because if you do that you don't create -- you  
5     creative incentives, yes, on one side but also you  
6     will actually create an incentive to put things in  
7     the clearinghouse that perhaps shouldn't have gone  
8     there.  So that is the kind of defined balance  
9     that you need to worry about.

10           And the second thing is I know I think  
11     you correctly said that you were going to have to  
12     look at those kind of projects actually are not  
13     already regulated by prudential regulators.  And  
14     obviously, you don't want to create some new  
15     loophole there as well.  So looking at what are  
16     the current capital standards that already apply  
17     to the rest of us basically that already have to  
18     pay those prudential capital requirements is very  
19     important.  So it's consistency that we care about  
20     obviously.

21           MR. RAMSAY:  We've been dancing around.  
22     A lot of the comments here have sort of been

1 dancing around issues involving the interests of  
2 end-users but I'm not sure that we've really kind  
3 of addressed that sort of head-on. So I guess  
4 maybe I'll sort of ask a general question or maybe  
5 preface it by saying that the -- I think perhaps a  
6 fair reading of legislative history and the  
7 congressional intent could be to suggest that this  
8 market, the swaps market in particular, not  
9 necessarily CDS market, is overly concentrated in  
10 terms of market share, that part of what we ought  
11 to be doing through the exercise of the regulatory  
12 authority in clearing is to open that up, to make  
13 it more competitive, to provide access more  
14 readily to a broader class of people, including to  
15 end-users.

16 If that's a fair read, then how should  
17 we as regulators go about it and how should  
18 clearing agencies provide access to end-users.

19 I'll start there. Does anybody want to --

20 MR. CAWLEY: Why don't I jump in? As a  
21 representative of the SDMA that represents  
22 independent dealers and FCMs, I think you look to

1 the fact and you look to the core principles of  
2 the act in terms of open access. And I think away  
3 from the core principles of the act in terms of  
4 open access and requirements for transparency and  
5 so forth, you look to the -- you look to the  
6 prudential nature of the risk inherent in any  
7 system that is too focused and too concentrated.  
8 So what role then can more FCMs again properly and  
9 adequately capitalize? What role can they play?

10 Well, within the FCM, within the  
11 clearinghouse structure they can burden some of  
12 the risk and they can distribute that risk. For  
13 independent dealers to provide additional  
14 liquidity into the system, that can only bring  
15 greater stability in the system, especially in  
16 times of crisis when you need it most. More  
17 people coming in making more markets and more  
18 products is simply better for the system overall.  
19 So, again, what -- you've got to ask yourself  
20 what, from the clearinghouse standpoint, what can  
21 be done to bring in entities who are well  
22 capitalized who serve and who are very active in

1 the same clearinghouse in other market contexts  
2 but are thus far not yet set up in this system.  
3 And there are initiatives right now that are going  
4 on where that's changing, which is very good. But  
5 again, you know, where you have dealer -- the way  
6 in which liquidity and market making has evolved  
7 in this marketplace over the past two decades  
8 since the inception of interest rate swaps and  
9 most recently credit default swaps is really on a  
10 dealer to client basis governed by an ISDA. And  
11 that market structure is going to change because  
12 you have a sort of flattened multilateral prospect  
13 where not only dealers to dealers trade with each  
14 other but also dealers to customers. And indeed,  
15 customers trading with customers. So, again, you  
16 know, you've got when two parties come together  
17 and they do a trade, the byproduct that they throw  
18 off on that trade is liquidity. So that should  
19 really be encouraged.

20 MR. DIPLAS: I would slightly question  
21 your underlying assumption in terms of how  
22 competitive the market is. If you look at this

1 industry and you compare it with some of the  
2 industries actually extremely infrastructure  
3 heavy. You have, I think, you look at something  
4 like buying cable service, buying a telephone,  
5 buying whatever. You don't have 15 dealers  
6 obviously competing over one another for fractions  
7 sometimes of a basis point. So that's kind of --  
8 but I'll answer the question anyway.

9           The issues -- there can be open access  
10 and there should be free competition. Whoever  
11 comes into these frameworks come in with the same  
12 rights but also with the same responsibilities.  
13 But then the market can compete and I think  
14 clients are going to freely go wherever they think  
15 someone offers them more liquidity.

16           In terms of CDS in particular as an  
17 asset class, you do have to be cognizant of the  
18 fact that it is more capital heavy as an asset  
19 class. It is something that is subject to jumps  
20 so that the participants who actually are in there  
21 will have to be cognizant of themselves that they  
22 will be subject to those jumps. And that is what

1 has basically weighted sometimes participates in  
2 the past. In the good times they get in and in  
3 the bad times they get destroyed. Again, the  
4 market forces take care of that on their own.  
5 It's not for us to prescribe but I don't see that  
6 there are any barriers in this sense. Clearing  
7 doesn't even lower any barriers. Anybody who  
8 complains, they can equally go to the  
9 clearinghouse and then you can trade with whoever  
10 you want. And I think we'll see that.

11 MR. GOOCH: I think one thing. You  
12 asked the question about how we bring more  
13 end-users into the marketplace. And I think they  
14 have somewhat different issues and maybe some  
15 firms like Jamie's that want to be FCMS that most  
16 end-users you haven't traded derivatives. If you  
17 sit down with them and say why do you only trade  
18 futures and not derivatives, the main thing  
19 they're worried about is uncertainty. They look  
20 at the OTC asset class and they get nervous about  
21 a bunch of things. They get nervous about legal  
22 certainty of the trades. They get nervous about

1 the documentation. They get nervous about the  
2 marking. A whole bunch of things. And that  
3 discourages a lot of people from trading  
4 derivatives.

5           And if we can encourage more of those  
6 people into the market, that's probably a good  
7 thing because they have economic risks they need  
8 to cover and there's more people in the market,  
9 there's more liquidity. It means there will be  
10 room for more dealers to cover the infrastructure  
11 costs and assets we're talking about. And I think  
12 that's the fix to the problem, is just to make the  
13 marketplace bigger. And you need to, I think,  
14 spend more time with the pension funds, the  
15 traditional money managers, the people who have  
16 lots of economic assets but choose not to use OTC  
17 derivatives to hedge them. Most hedge funds do,  
18 so that's not really the issue.

19           Those guys are looking for your  
20 certainty in the course of the trade and they get  
21 very nervous about, you know, I do a trade that is  
22 enforceful or not enforceful until it gets to the

1 clearinghouse. They all have different views of  
2 what the answer should be but what they're looking  
3 for I think out of this process is a lot of  
4 certainty about every step in the trade. Some of  
5 them love ISDA documents; some of them hate ISDA  
6 documents with a passion. You know, I don't think  
7 there's anyone that you ought to tell them what  
8 they should and shouldn't like in terms of  
9 documentation but I do think at the end of this  
10 process they want a world where they understand  
11 the risks they take, they understand what happens  
12 if there's a credit event on the trade. They  
13 don't have to worry about those things.

14 I think that will encourage more people  
15 in. And the minute it just looks expensive from  
16 an infrastructure perspective and creates doubt in  
17 their mind about what they're doing. And I think  
18 we can solve that through this process. More  
19 people will come in, the market will grow, you'll  
20 naturally get more dealers because it'll be more  
21 attractive, and that liquidity bridge, liquidity  
22 will end up in a much better place. But often we

1 talk too much about dealers and midsize dealers  
2 and clearinghouses and forget the market is  
3 actually driven by pension funds, traditional  
4 money managers, and others in the credit space  
5 actually want to trade the asset class and they  
6 have a very different set of needs.

7 MR. HARRINGTON: One of the things we're  
8 seeing from our buy side customers today and this  
9 is dramatically ramped up since July and the  
10 passage of the Act, the two main tenets of the --  
11 with transparency and then obviously clearing,  
12 that in and of itself is bringing back actually  
13 two distinct customer groups. Number one,  
14 customers who prior to 2008 had been using OTC  
15 derivatives either in small or large scale but  
16 then also new participants who had never, you  
17 know, never been involved in OTC at all who now  
18 have a strong interest mainly because of the fact  
19 that, you know, the mitigation of counterparty  
20 risk is from what we hear probably the primary  
21 driver. But then secondly with the, you know,  
22 with the tenets of transparency, the fact that

1 there's going to be so much more data available,  
2 you know, whether, you know, depending on the rule  
3 making whether it's close to real time, close to  
4 end of day, whatever it ends up being, it's going  
5 to be dramatically more than what we have today.  
6 And that, in and of itself, is going to bring in  
7 participants and liquidity into the markets.

8 MR. TURBEVILLE: My experience with end  
9 users, companies that are hedging or mitigating  
10 risk and embedded in their businesses because all  
11 this is true but the bigger issue is cash. And  
12 the biggest uncertainty is having to post margin  
13 and watching their businesses go down in flames  
14 for lack of cash because they're not banks.  
15 They're not pension funds. They're airlines.  
16 They're utilities. They're whomever might be  
17 hedging the risk. So that the biggest concern  
18 with entering into -- of limiting himself to a  
19 clearing environment is that they lose access to  
20 bilateral transactions in which debt or credit  
21 extension is embedded.

22 So that's the real driving factor in all

1 of this, which leads to the question whether a  
2 system that is bifurcated where you have the  
3 clearing system and FCMs extend credit and where  
4 you have another system where banks embed credit  
5 deals in derivatives is a good system. But that's  
6 the system we're in. And that's what we'll -- the  
7 less attractive the embedded credit deal is in and  
8 bilateral transaction is, the more clearing will  
9 occur.

10 MR. RAMSAY: Right. So some would  
11 suggest that, you know, those contracts that the  
12 credit extension are embedded in the price but  
13 embedded in an opaque way, in a way that's not  
14 ideal and most efficient --

15 MR. TURBEVILLE: Really? I've never  
16 heard of that.

17 MR. RAMSAY: Some would suggest. So  
18 does that prompt any suggestions about in terms of  
19 the machinery of the clearinghouse, you know,  
20 representation of end-user interests? Is it  
21 appropriate to have a specific end-user  
22 representation on the board, on the risk

1 committee, on, you know, sort of a key --

2 MR. TURBEVILLE: Maybe more creative  
3 ways to -- I mean, I think this is all about  
4 credit. I mean, more creative ways to provide  
5 credit into the system so that credit for  
6 margining can be accessed. And the other thing  
7 is, of course, more -- less lack of transparency  
8 on the other side.

9 MR. PIRRONG: I just wanted to go to  
10 sort of the premise of your question which was  
11 about the markets being concentrated and there was  
12 sort of an implicit assumption there that they  
13 were too concentrated. Well, I think it's  
14 important to recognize, I think first of all we  
15 should ask the question, well, why did they get to  
16 be that way? There are fundamental economic  
17 factors that are driving that. What are those  
18 economic factors? I can think of some good ones  
19 and I can think of some bad ones. For example,  
20 sort of too big to fail subsidies could be one  
21 thing that would be encouraging excessive  
22 concentration.

1           But on the other hand, I can think of  
2 good just sort of economy and scale and scope  
3 reasons that are leading to this kind of  
4 concentration. And I think it's important to  
5 start from a fundamental understanding of what the  
6 economics are as opposed to saying, oh, the market  
7 is too concentrated. Let's force a less  
8 concentrated structure which might actually be  
9 sort of going against the underlying economics and  
10 force on excessive cost and perhaps excessive  
11 risk.

12           I think one of the -- one of the points  
13 that I hear raised often as well, is the standards  
14 for membership are too high. And there are sort  
15 of two factors on that. One is to talk about the  
16 financial requirements of, you know, net capital,  
17 and two is, points around the need to provide  
18 daily pricing for CDS clearing and to participate  
19 in the unwind upon the default of a counterparty.  
20 And I think you have to think about this in terms  
21 of, you know, the questions about what should be  
22 mandated and how far do we clear and questions

1 about this are directly tied together.

2           So the fundamental principle behind the  
3 clearinghouse is we have sufficient daily pricing  
4 that we can know what the variation margin should  
5 be. And by having sufficient daily pricing we're  
6 able to calculate an appropriate IM and an  
7 appropriate guaranty fund to ensure that we're  
8 safe. If we have products that are liquid enough  
9 in that clearinghouse that you don't need to rely  
10 on the members for daily pricing, then that's  
11 going to lead you to a different answer for what  
12 your membership standard should be. If you have  
13 products that aren't liquid enough, you know, if  
14 you look at some of the DTTC's statistics they  
15 have published on the nine month study that you  
16 guys did on trading volume, well below -- well  
17 more than half of the thousand single names they  
18 looked at had less than five trades a day across  
19 the entire curve. So on a 10-year curve, four  
20 points a year, 40 products per credit, there were  
21 less than five trades a day.

22           And the way I think about it is it

1 should be an open -- it should be open access but  
2 you need to have certain standards to get a  
3 driver's license. And those standards change  
4 based on the type of vehicle you're driving. So  
5 if you're just going to drive a car, there's one  
6 set of standards. If you're going to drive a Mack  
7 truck, there's a different set of standards. And  
8 that means regulators kind of have a choice. And  
9 I think part of this is, you know, what was  
10 intended by Dodd-Frank. But if your choice is to  
11 say we're only going to have clearing of the  
12 highly liquid products, that's going to be a very  
13 narrow interpretation of what's cleared and you're  
14 going to end up with a broader set of those who  
15 can handle the client risk that they're taking on  
16 and they're introducing into the system and who  
17 are able to participate in the risk management  
18 system. And the mutualizing of that risk between  
19 members.

20 If you go for a broader set of what's to  
21 be clear, which I think seems to be what everyone  
22 thinks is the intent of Dodd-Frank and certainly

1 from the approach of the clearinghouses is what  
2 they're targeting, then I think you have to set a  
3 narrower standard, you know, you have to set  
4 higher standards for who's able to participate in  
5 that. And that's all really based on this issue  
6 of how liquid are the products that we're clearing  
7 and do we have enough pricing externally that we  
8 don't need to rely on that from the members?

9 MS. JOHNSON: I will, I would just add  
10 that part of the concentration is certainly the  
11 result of the adoption of the Commodities Future  
12 Modernization Act in 2000 and the definition of  
13 eligible market participants, and/or in  
14 combination with the Gramm-Leach-Bliley Acts  
15 removal of those sort of into an unregulated zone.  
16 So I think some of the concentration was largely  
17 the part of legal construct limiting who could  
18 actually participate in the market. And that  
19 legal construct was based in part on what Tom is  
20 mentioning, the concerns about liquidity in the  
21 market and the ability of pension funds or other  
22 sort of more sensitive types of investors'

1 abilities to access the opportunity to liquidate  
2 the positions if they needed to in a particular  
3 emergency.

4 MR. RADHAKRISHNAN: I think there is  
5 another dimension to access. One is access to  
6 credit membership, which Tom just talked about.  
7 But the other dimension is the access of end-user  
8 or clients to having their products cleared. In  
9 the futures model everybody has access because you  
10 get no choice. Right? When you trade a futures  
11 contract you've got to clear it. Right? Either  
12 you do it directly or you do it through an  
13 intermediary. So the question I have is I believe  
14 that there is not enough client clearing for  
15 credit right now. And tell me if I'm wrong. And  
16 if I'm wrong, why is that so?

17 MR. DIPLAS: Well, we couldn't tell you  
18 it's wrong because there's not enough client  
19 clearing. So that's probably the easiest part of  
20 the debate today.

21 Look, I mean, we already -- the fact  
22 that credit clearing has taken us three or four

1 years to actually get it done is because it is  
2 totally complex. We're dealing with an underlying  
3 instruments complex. We have to work out a lot of  
4 issues. Obviously, the moment we introduce client  
5 clearing it raised the complexity by another order  
6 of mine because suddenly we are dealing with  
7 instead of three parties, you're dealing with four  
8 parties. Part of the issue we had was that  
9 actually we were dealing with participants in  
10 multiple legal jurisdictions and we had to face  
11 multiple backup (inaudible) trying to figure out  
12 how to work all of those.

13 Now, one good thing coming out of  
14 Dodd-Frank is actually because of the imposition,  
15 for example, of the FCM requirement is that it  
16 simplifies some of that framework and therefore  
17 now we can go back and deal with an easier  
18 framework and actually I think we're going to be  
19 more successful in that respect. So that's why it  
20 took so long but I think we have some concrete  
21 steps in front of us to actually get this done.

22 MS. TAYLOR: I think one of the issues

1 that we're all facing is that we're all trying to  
2 hit a moving target. A lot of what Tom said is  
3 very, very applicable. It definitely serves the  
4 customers better and it serves actually the  
5 clearinghouses better from a risk management point  
6 of view to have a more diverse group of clearing  
7 member participants as long as that diverse group  
8 of clearing member participants has the capacity  
9 and the expertise to perform the functions that  
10 we're asking them to perform.

11           And right now the set of functions that  
12 we're asking a clearing participant in a CDS  
13 offering to perform include some functions that  
14 are probably not widely available. There isn't a  
15 huge universe of entities that are able to perform  
16 those functions. As the markets become more  
17 transparent, more widely traded, particularly  
18 certain products I think will become -- will adapt  
19 more readily to the electronic execution, I think  
20 we need to have a set of standards that will allow  
21 the market to evolve as -- the standards to evolve  
22 as the market evolves. In our particular case

1 we've got a much lower minimum capital hurdle to  
2 be a clearing member than other clearing providers  
3 for CDS. Over time, that's likely to be an  
4 operative hurdle. Right now I think the operative  
5 hurdle is the expertise and the capacity to  
6 perform things like participate in the pricing,  
7 participate in the default management, you know,  
8 stand ready to take your share of a portfolio that  
9 we need to liquidate. And there is not as large a  
10 universe of participants as we would like who are  
11 able to do those things. And I think that will  
12 change over time, but I would encourage you to  
13 think about that evolution as you try to set  
14 standards because you're trying to hit a moving  
15 target, too.

16 MR. EDMONDS: Yeah, on that point,  
17 someone calls you up and says -- I get these phone  
18 calls from time to time. I'm a SEF. Really?  
19 Okay. And you have to provide open access because  
20 you're a clearinghouse. I'm like, I'm aware of  
21 what the statute says. But you haven't yet  
22 determined what a SEF is. And I draw that analogy

1 because as it relates to the buy side and the  
2 interests they have, they are certainly interested  
3 in the protections that are provided in a CCP and  
4 the functions that collectively some of us in this  
5 room provide. They haven't yet been able to, much  
6 like you haven't been able to yet put your arms  
7 around exactly what a SEF is, we'll kind of know  
8 it when we see it, they know that that is coming.  
9 They are anticipating the delivery of those  
10 services, but yet they need to plan for that.  
11 They need to understand what the requirement will  
12 be on them. They need to understand what their  
13 capital planning process, how it's going to be  
14 modified and changed. Some of them will change  
15 their business models and they will have to by  
16 definition change the business models in which  
17 they operate. We don't yet, to Kim's point about  
18 a moving target, we have not yet provided enough  
19 information. Dodd-Frank, the passage of that and  
20 the execution is now law. The next step -- the  
21 next iteration in this process is going to be the  
22 rules that these agencies, your agencies develop

1 and provide. And we will look back on this in two  
2 years and go, well, it was all just, of course it  
3 was. We all just knew that.

4 But right now we're in the middle of  
5 mixing the batter, so to speak. And that is as  
6 frustrating for the buy side as it is for anyone  
7 else who is materially involved in this. But at  
8 least we've removed the uncertainty around whether  
9 or not we're going to have to or not going to have  
10 to. But that's only one piece of this puzzle that  
11 is a significant puzzle that we're all playing a  
12 piece in.

13 MR. CAWLEY: I'd like to discuss or  
14 respond somewhat to Kim and to Tom's comments  
15 about requirements for FCMs and the openness and  
16 what qualifies. I think certainly, you know,  
17 we're not suggesting for a second that there  
18 should be two sets of rules for two sets of FCMs.  
19 What we are saying is that yes, capital is an  
20 issue. And sophistication and the ability to  
21 trade and participate in the auction process in  
22 the event of an FCM is vital for the success of a

1 clearinghouse to operate. But there are, and I  
2 think you'll agree, several clearing brokers or  
3 FCMs out there in excess of 20 to 30, 40 billion  
4 capital who exceed your requirements who from a  
5 capital standpoint are certainly eligible to  
6 participate.

7           There's also innovative ways in which --  
8 and Tom, to your point -- you can never have  
9 enough pricing when it comes to liquidity, when it  
10 comes to a liquidation situation. So if a  
11 clearinghouse is offered from other dealers who  
12 are seeking to enter the space who can provide  
13 liquidity and put their money where their mouth is  
14 and take some of that burden and wear some of that  
15 risk, I think it should behoove us all as an  
16 industry given the nature of this whole process  
17 that discourse should continue such that you bring  
18 in greater -- more pricing, more dealers, more  
19 FCMs to participate in the process.

20           When it comes to the auctioning of  
21 positions of a distressed FCM, I think it's fair  
22 to say that you can never have enough participants

1 in an auction. So you know, what I would suggest  
2 and what we've contemplated is very simple, is  
3 open up that auction process to include the buy  
4 side. To include 400 to 500, 600 accounts. There  
5 is precedent in the marketplace today where  
6 auctions operate in a timely and efficient manner  
7 when positions are auctioned off in the market  
8 space today. So there is precedent out there.  
9 There are many people who wish to participate in  
10 these auctions. The buy side, new independent  
11 dealers, L dealers of credit. There's a new  
12 monopoly of information concentrated in a  
13 particular few firms. So again, there are a  
14 number of guys out there with capital who wish to  
15 participate. There's a number of dealers out  
16 there who wish to contribute prices who want to  
17 share that burden. And indeed, there are a number  
18 of buy side accounts out there who would love the  
19 opportunity to participate in an auction,  
20 especially as Matthias had mentioned very early on  
21 that there should be some discount given in an  
22 auction process. We don't think there should be

1 any discount given in an auction process. We  
2 think there should be a best price and that best  
3 price is assuredly optimized when you have 400  
4 bidders in a room and not just six.

5 MR. DIPLAS: I think it's very important  
6 to go back to that point though. We're not  
7 talking about asking other people to come in and  
8 that is a problem. Clearly, when we have an  
9 auction the more people that come in the better.  
10 That's fine. What we are talking about is who is  
11 actually contractually obligated to participate in  
12 the auction? That is what the issue is here. Who  
13 is contractually obligated to price the stuff on a  
14 daily basis and participate in an auction. The  
15 problem we have in the situation such as Lehman  
16 defaulting is not that we have too many people  
17 actually participating in an auction; we have too  
18 few. That's the issue we have.

19 So if you want to come in and  
20 participate, everybody is welcome. If you come in  
21 with the same rights and the same responsibilities  
22 but you have to contractually be having the same

1 obligations. So there is no issue after that.  
2 But to say that somehow if you cannot provide  
3 those services, that you might outsource them to  
4 someone else and they might be on the hook or  
5 might not be on the hook is a very uncertain  
6 situation and it makes it very uncomfortable.

7 MR. RADHAKRISHNAN: That will be -- that  
8 whole issue you just talked about is going to be a  
9 -- I hope will be a subject of another discussion.  
10 But unfortunately -- because it is a very -- it is  
11 a very important discussion as to the structure of  
12 clearinghouses and I'm not committing ourselves to  
13 another roundtable but I would like to have  
14 another sessions.

15 With that we have to end. I really  
16 would like to thank each and every one of you for  
17 your contributions. I think it helped us a lot.  
18 I know it was, you know, you took a lot of time  
19 off your busy schedules and we appreciate it very  
20 much.

21 Before I end, I would like to remind  
22 everybody -- I don't know if this is being webcast

1 but, you know, in the Federal Register release we  
2 did invite comment and there are specific  
3 mailboxes that you can send us your comments. And  
4 also, when we do come out with our respective  
5 agencies' comment on the rulemakings, we hope that  
6 you will comment.

7 But thank you very much. We will  
8 adjourn for now and 1 o'clock is the next  
9 roundtable. So thank you.

10 (Whereupon, at 12:07, the  
11 PROCEEDINGS were adjourned.)

12

13

\* \* \* \* \*

14

15

16

17

18

19

20

21

22