

UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

MARKET RISK ADVISORY COMMITTEE MEETING

Washington, D.C.  
Wednesday, January 31, 2018

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2 Commissioners:

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4 Sponsor)

5 CHAIRMAN J. CHRISTOPHER GIANCARLO (CFTC)

6 COMMISSIONER BRIAN D. QUINTENZ (CFTC)

7 Other Participants:

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

2 (10:00 a.m.)

3 MS. LEWIS: Good morning, everyone. My  
4 name is Alicia Lewis, and as the Market Risk  
5 Advisory Committee's designated Federal Officer,  
6 as well as its Acting Chair, it is my pleasure to  
7 call this meeting to order.

8 Before we begin today's Panels, I would  
9 like to turn to Commissioner Rostin Behnam, the  
10 MRAC sponsor to give welcome remarks. After  
11 Commissioner Behnam gives his remarks, we will  
12 have opening remarks starting with Chairman  
13 Giancarlo; then Commissioner Quintenz; and then  
14 Commissioner Behnam.

15 COMMISSIONER BEHNAM: Thanks, Alicia.  
16 Good morning to everyone, welcome. Welcome to the  
17 folks in the audience; of course, those on the  
18 webcast and, most importantly, the members of the  
19 MRAC. It means a lot to me, and I know Chairman  
20 Giancarlo and Commissioner Quintenz that you're  
21 here today. It certainly is a long day and many  
22 of you travelled from outside of the District, so

1       it means a lot to us and the Commission; and we're  
2       looking forward to a good healthy conversation.

3               Before we get started with the formal  
4       remarks, I do want to take a quick minute to thank  
5       CFTC staff. For many of you, you know this room  
6       is not typically set up like this; and it's a lot  
7       of work that goes into setting up the room, both  
8       for the AV, internally and externally for the  
9       webcast; so I do want to take a moment to thank  
10      them for all of their work. So, with that, thanks  
11      again for everyone for being here, and appreciate  
12      all of your work, and looking forward to a good  
13      conversation today. Thank you.

14             MS. LEWIS: Thank you, Commissioner  
15      Behnam. And now we'll have opening remarks;  
16      Chairman Giancarlo.

17             CHAIRMAN GIANCARLO: Thank you, Alicia.  
18      Good morning, everybody. A warm welcome to all of  
19      the MRAC members; those who are here; and to other  
20      participants; and those who are on the telephone,  
21      it's good to have you. And I must say, it is  
22      really good -- this is the first public meeting of

1 the new Commission, and it's great to be seated  
2 here with my two fellow Commissioners,  
3 Commissioner Behnam and Commissioner Quintenz.  
4 Hopefully, the three of us will have company up at  
5 this dais sometime this year.

6 Today, we'll continue the CFTC's history  
7 of thoughtful and thought-provoking advisory  
8 committee hearings under this new commission. We  
9 had hoped, as you know, to kick off that  
10 continuation last week with a TAC Committee  
11 meeting; but, unfortunately, that meeting had to  
12 be rescheduled. Nevertheless, Commissioner  
13 Quintenz, Dan Gorfine and the TAC members have  
14 done a lot of preparation; so, it's going to be a  
15 great program when it takes place on February  
16 14th, which is Valentine's Day; so, please don't  
17 miss it. And our other advisory committees, AG,  
18 Energy, and the Global Markets will also have  
19 scheduled meetings in the months to come.

20 But today, we kick off the year with  
21 MRAC; and, as you know, this Committee was very  
22 active and very effective under former

1 Commissioner Sharon Bowen. No doubt such good  
2 work will continue under Commissioner Behnam,  
3 designated Federal officer, Alicia Lewis, and the  
4 MRAC Committee members that are gathered here  
5 today.

6 Today, the Committee will discuss the  
7 product self-certification process under Part 40  
8 of the Commission's regulations; and it's an  
9 excellent program. Two weeks ago, I had the honor  
10 to speak at the annual conference of the ABA  
11 Section on Derivatives and Futures Law. I  
12 discussed derivatives on virtual currencies and  
13 the appropriateness of requirements under CFTC  
14 regulations for the review of such products. I  
15 spoke about the review and compliance checklist  
16 that the CFTC staff deploys to ensure that  
17 self-certified virtual currency futures products  
18 and their cash settlement processes are not  
19 readily susceptible to manipulation, and that  
20 virtual currency derivative products are  
21 sufficiently margined.

22 And I also said that I was neither an



1       apologist nor an opponent of the current process  
2       of self-certification; rather I and my fellow  
3       Commissioners are inheritors of that process.  And  
4       we're not the first Commission to have a  
5       conversation about the right balance of interest  
6       for the self-certification process.  That's a  
7       conversation that's predated virtual currencies.  
8       But I also said that it's quite clear that  
9       Congress and prior commissions designed the  
10      product self-certification framework to give the  
11      DCMs -- in the role as SRO, Self-Regulatory  
12      Organizations -- the ability to design and certify  
13      new products.  Congress deliberately framed the  
14      self-certification process so that development of  
15      derivative products would not be stalled by  
16      regulators, wary of the political risks of  
17      approving new products.  And I went on to say that  
18      the CFTC's current product self-certification  
19      framework is generally consistent with public  
20      policy that encourages market-driven innovation  
21      that has made America's listed futures markets the  
22      envy of the world.

1                   Well, a week after that ABA conference,  
2                   I met in Washington with a senior European markets  
3                   regulator to discuss a range of different topics.  
4                   Unprompted, he brought up the CFTC's  
5                   self-certification process; and he said that he  
6                   thought it was the reason why most new financial  
7                   products originated here in the United States. In  
8                   fact, he had a point. According to CFTC.gov, less  
9                   than 800 futures products were approved by the  
10                  CFTC prior to self-certification; and since then,  
11                  U.S. exchanges have self-certified over 10,000 new  
12                  products, far more than any overseas marketplace.  
13                  It struck me that sometimes it helps to be  
14                  reminded of our advantages by our foreign  
15                  competitors. Now, that's not to say, however,  
16                  that existing review processes should not be  
17                  assessed, and where appropriate, improved.

18                  At the ABA conference, I noted criticism  
19                  from some market participants that the CFTC did  
20                  not hold public hearings prior to  
21                  self-certification of Bitcoin futures. I pointed  
22                  out, that unlike provisions in the Commodity

1 Exchange Act and Commission regulations that  
2 provide for public comment on rule  
3 self-certification, there is no provision in the  
4 CEA or regulations for public input into CFTC  
5 staff review of product self-certifications. It's  
6 hard to believe that Congress was deliberate in  
7 making that distinction. In fact, it is the DCMs  
8 and DCOs, and not the CFTC staff that must solicit  
9 and address stakeholder concerns in new product  
10 self-certifications. Interested parties,  
11 especially clearing members, should, indeed, have  
12 an opportunity to raise appropriate concerns for  
13 consideration by regulated platforms proposing  
14 virtual currency derivatives and DCOs considering  
15 clearing new virtual currency products.

16 That is why I've asked the CFTC staff to  
17 add an additional element to its review and  
18 compliance checklist for virtual currency product  
19 self-certifications. That is, requiring DCMs and  
20 SEFs to disclose to CFTC staff what steps they  
21 have taken in their capacity as self-regulatory  
22 organizations to gather and accommodate

1 appropriate input from concerned parties,  
2 including trading firms and FCMs.

3 Further, I've asked the staff to take a  
4 close look at DCO governance around the clearing  
5 of new virtual currency products and formulate  
6 recommendations for possible further action.

7 In closing, I believe the issues raised  
8 by self-certification of virtual currencies are  
9 the degree of responsibility of DCMs under the CEA  
10 and Commission regulations to ensure that virtual  
11 currency derivatives are not readily susceptible  
12 to manipulation; and a degree of responsibility of  
13 DCOs, under the CEA and regulations, to ensure  
14 that virtual currency derivatives are sufficiently  
15 margined.

16 I look forward to today's discussion of  
17 these important issues; it's timely. We see  
18 what's on the horizon and we must be prepared and  
19 be responsible. As we confront the challenges  
20 ahead, we will look to the thoughtful  
21 deliberations of advisory committees like this one  
22 today. I thank, again, Commissioner Behnam for

1 organizing this meeting, along with Federal  
2 officer, Alicia Lewis; and I thank all of you for  
3 attending and participating. Thank you very much.

4 MS. LEWIS: Thank you, Chairman  
5 Giancarlo; Commissioner Quintenz.

6 COMMISSIONER QUINTENZ: Thank you very  
7 much. Thank you Commissioner Behnam for your  
8 leadership of this advisory committee and for  
9 convening today's meeting; and Alicia for your  
10 very hard work in organizing. I look forward to  
11 very thoughtful discussion today on the process by  
12 which exchanges may list contracts for new or  
13 novel products, and the CFTC's role in that  
14 process; and let me just say that I agree with  
15 Chairman Giancarlo's long-held and  
16 well-articulated belief in regulation's ability to  
17 foster financial market innovation. I believe  
18 that the self-certification process of new  
19 financial products can play an important role in  
20 realizing that philosophy.

21 Specifically, the self-certification  
22 process ensures that the market's introduction of

1 new products is not delayed by regulator's  
2 political considerations. It reflects the  
3 government providing the market with the freedom  
4 and space to innovate outside of Washington  
5 bureaucracy and on a market timeframe, not a  
6 bureaucrat's; and I think we can all benefit from  
7 that market-based approach.

8           Let me also quickly take a moment to  
9 discuss the concept of risk, which is a term that  
10 seems to get thrown around very broadly, mostly  
11 with negative connotation in connection with our  
12 financial markets. For those who want regulators  
13 to remove all financial risk from the marketplace,  
14 I have news for you. That cannot and will not  
15 happen. Every element of the financial system  
16 has, and always will have, risk. Our market's  
17 ability to empower risk takers to provide feedback  
18 on value creation vis-a-vis that risk, and  
19 transfer risk to those most willing and able to  
20 bear it, are what make our markets the envy of the  
21 world. I would seek to preserve those market  
22 functions, not bureaucratize them.

1           As for today, while we're focusing on a  
2 self-certification process, I think a little  
3 perspective is also necessary. I must note that  
4 self-certification is where a new contract's  
5 regulatory life begins, not where it ends. After  
6 a contract self-certification and its initial  
7 listing, the CFTC will then surveil that product's  
8 trading and clearing activity on a daily basis;  
9 review every new rule issued by exchanges and  
10 clearinghouses affecting that product; and  
11 regularly perform market-wide and  
12 clearinghouse-level stress tests incorporating  
13 that product's margin sufficiency.

14           In addition to supervision by the CFTC,  
15 the trading of new contracts is subject to  
16 oversight by the exchanges to ensure that the  
17 contract complies with the core principles set  
18 forth in the CEA and CFTC regulations, including  
19 that the contract is not readily susceptible to  
20 manipulation, and is subject to rules ensuring the  
21 contract's financial integrity.

22           Further, as to risk assumed by FCMs, FCM

1 positions are continually monitored; their trading  
2 activity is subject to potential trading halts;  
3 and their risk management policies are reviewed on  
4 a regular basis.

5           Lastly, regarding public input. The  
6 CFTC is and always should be receptive to hearing  
7 public concerns regarding a new product and the  
8 process by which it was listed. I'm very pleased  
9 that this MRAC meeting has been convened to  
10 provide a forum to discuss any potential concerns  
11 that the public may have with the process for  
12 listing new and novel products; and I look forward  
13 to hearing today from participants about the types  
14 of risk that exchanges consider when deciding to  
15 list a new product; how exchanges assess whether a  
16 cash market is sufficiently transparent and liquid  
17 to support accurate and fair pricing for related  
18 derivatives products; and whether exchanges and  
19 clearinghouses have adjusted their risk management  
20 practices following particular product launches.

21           In closing, I'd like to note that  
22 nothing says Valentine's Day like a Technology



1       Advisory Committee meeting; so, please mark your  
2       calendars for February 14th. I look forward to  
3       welcoming some of you back for that, and  
4       appreciate all of your interest in it. We'll be  
5       having a very robust discussion regarding  
6       cryptocurrencies, block chain, automated trading  
7       and cybersecurity; but, in closing, thank you  
8       Commissioner Behnam, and the members of the MRAC  
9       for coming here today and being with us, and being  
10      a part of the discussion.

11                   MS. LEWIS: Thank you, Commissioner  
12      Quintenz; Commissioner Behnam.

13                   COMMISSIONER BEHNAM: Welcome again to  
14      the first Market Risk Advisory Committee meeting  
15      of 2018. I'm pleased to sponsor this committee  
16      and believe my timing to address important market  
17      risk issues cannot be better. Groundbreaking new  
18      ideas have gone from theory to application in just  
19      the past few months. I'm especially mindful and  
20      appreciative of the Commission's ongoing efforts  
21      to affirmatively exercise its regulatory authority  
22      and expertise while remaining ever vigilant of the

1 risks associated with the adoption of nascent  
2 technologies.

3           Before we move into the substance of  
4 today's meeting, I want to thank Commissioner  
5 Quintenz and Chairman Giancarlo for being here  
6 today and their contributions to this discussion.  
7 Also, I want to thank today's Moderator, Paul  
8 Architzel. Before entering private practice, Paul  
9 spent more than 25 years at the CFTC in the Office  
10 of the General Counsel and as chief counsel in the  
11 CFTC's former Division of Economic Analysis, now  
12 the Division of Market Oversight. Paul played a  
13 leading role in many rulemakings that shaped our  
14 current processes for new product review and  
15 approval. Since leaving the Commission in 2013,  
16 Paul has remained an active and well- respected  
17 member of the Derivatives Bar.

18           I want to thank each of the Panelists.  
19 We've gathered a distinguished group of speakers  
20 and their readiness to participate is greatly  
21 appreciated and critical to today's discussion. I  
22 want to thank Alicia Lewis, the Committee's

1 Designated Federal Officer. Alicia started  
2 working in my office in mid-December, and MRAC was  
3 issue number one on day one; and she's handled the  
4 role with great professionalism and discipline;  
5 and the quality of her work will be on display  
6 today.

7 I also want to thank the members of the  
8 MRAC. Today, we welcome two new members, Jason  
9 Cohen, Chief Executive Officer of NEX SEF, and  
10 Kathleen Cronin, Senior Managing Director and  
11 General Counsel of CME Group. Jason and Kathleen  
12 will be taking the place of departing MRAC  
13 members, John Nixon and Kimberly Taylor. Former  
14 Commissioner Bowen selected this impressive group,  
15 and you have all demonstrated the ability to  
16 tackle and opine on difficult and important  
17 issues. Your time and service is greatly  
18 appreciated.

19 However, as many of you know, the  
20 charter for this Committee will expire in the next  
21 few months. Today will likely be the last meeting  
22 of this group before we renew the charter and

1       reconstitute membership. As I recently stepped  
2       into my new role as sponsor of this Committee, it  
3       perhaps would have been sensible to renew, or  
4       repopulate, and set a new course for MRAC all at  
5       once; however, the introduction of two Bitcoin  
6       futures contracts caused many to inquire, perhaps  
7       for the first time, about the Commission's role in  
8       the listing of new products under the Commodity  
9       Exchange Act and Commission regulations.

10               While I commend the Chairman for  
11       releasing backgrounders on self-certification of  
12       Bitcoin products; recording a podcast roundtable  
13       with CFTC leaders on Bitcoin; and launching a  
14       Bitcoin education webpage, these communications  
15       can fall flat in the absence of meaningful  
16       dialogue. The launch of the Bitcoin futures  
17       product is a testament to the forward-thinking  
18       innovative spirit of the derivatives market. As  
19       the market and market participants continue to  
20       adopt technologies that make new products, new  
21       relationships, and new forms of conduct possible,  
22       I believe it's critical that the CFTC engage with

1 industry in addressing risk; provide legal and  
2 regulatory certainty to the market; educate the  
3 general public; and question and challenge the  
4 status quo, both in the market and within the  
5 Commission.

6 Today's four Panels are organized in  
7 order to ensure our dialogue remains focused on  
8 the issue of self-certification of new products.  
9 That being said, in thinking about this meeting  
10 and the Commission's recently announced approach  
11 and responsibilities with respect to virtual  
12 currencies, unquestionably, new and novel assets,  
13 the over- arching theme is largely one of process.  
14 We all should feel accountable for what we do but  
15 also for what we do not do; and while we are now  
16 living in an age that is not big on process, but  
17 often prefers to emphasize likes and tweetable  
18 sound bites, process is important because it  
19 provides the bearings, the connections in the  
20 record and in the story of how we accomplish our  
21 duties.

22 As the Chairman has recently noted, the

1 CFTC has received some criticism from large-market  
2 participants for not holding public hearings prior  
3 to self-certification of Bitcoin futures. That  
4 being said, as the most recent CFTC backgrounder  
5 notes, the product self-certification process does  
6 not provide for public input. In narrowing focus  
7 to the two big Bitcoin futures contracts, the  
8 Chairman clarified neither statute nor rule would  
9 have prevented CME and CFE from launching their  
10 new products before public hearings could have  
11 been called.

12           While the self-certification process  
13 does not expressly provide for public input, that  
14 does not mean the public input in the process of  
15 launching new and novel products is impossible or  
16 undesirable. To the contrary, dialogue between  
17 the Commission, the exchanges, and market  
18 participants is vital to the process.

19           I am hopeful that today's MRAC meeting  
20 will both shed light on the importance of such  
21 dialogue and, perhaps, provide the public input  
22 regarding Bitcoin futures that did not occur prior

1 to certification. At the very least, this meeting  
2 provides a forum for input regarding futures  
3 products in the virtual currency space.

4 The CFTC staff developed a standard of  
5 heightened review within the limits and parameters  
6 of the current self-certification process for  
7 determining whether the Bitcoin futures products  
8 comply with the exchanges' obligations under the  
9 CEA core principles and CFTC regulations and  
10 related guidance.

11 I fully support and commend the staff,  
12 under the direction of the Chairman, for taking  
13 initiative and quick action in a timely and direct  
14 manner to address concerns related to the listing  
15 of Bitcoin futures contracts despite the  
16 regulatory confines of the self-certification  
17 process.

18 However, the need for new heightened  
19 review process demonstrates that the Commission  
20 must reconsider its historical regulatory approach  
21 to new and novel products. In fact, the  
22 implementation of the heightened review process is

1 a new regulatory approach in and of itself. The  
2 approach, albeit well intentioned and  
3 appropriately calibrated to the level of risk  
4 presented by the Bitcoin products, has resulted in  
5 a muddled record; confusing story; and potentially  
6 a new hybrid process somewhere between  
7 self-certification and voluntary submission. Such  
8 changes require a more formal process subject to  
9 the rigors of Commission deliberation and public  
10 notice and comment.

11 I am pleased that the Chairman has asked  
12 the CFTC's General Counsel to propose for  
13 Commission consideration possible regulatory and  
14 statutory steps to better support the staff's  
15 approach to virtual currency product review.

16 I look forward to exploring our options  
17 which I hope will include some parameters for  
18 determining when self-certification may not be  
19 appropriate, and for determining when such matters  
20 are appropriately brought before the entire  
21 Commission.

22 To be clear, this meeting is not



1 intended to question the efficacy and usefulness  
2 of self-certification. Self-certification is a  
3 unique process that has served market  
4 participants, the CFTC, and the general public  
5 very well. Indeed, since Congress authorized the  
6 CFTC to establish a self-certification process for  
7 the listing of new products in 2000, exchanges  
8 have self-certified over 10,000 new products --  
9 providing more risk management tools for  
10 commercial end-users across many different asset  
11 classes.

12 As set forth in Part 40 of the  
13 Commission regulations, it is a process that  
14 relies on the act and core principles as the  
15 benchmarks and standards for how an exchange and  
16 derivatives clearing organization must design a  
17 product. Any action above and beyond this must be  
18 subject to Commission action so the Commission, as  
19 a whole, may deliberate the merits and consider  
20 the risks of new products in a transparent forum.

21 Our first Panel today, will focus on the  
22 statutory and regulatory frameworks and processes

1 with respect to the listing of new products and  
2 self-certification. A part of the discussion will  
3 be devoted to clarifying the different internal  
4 processes associated with self-certification vs.  
5 Voluntary approval.

6 Of particular relevance to me is the  
7 Commission's flexibility under each of the  
8 governing Commission rules to assure the  
9 opportunity for thoughtful analysis and public  
10 comment, only in appropriate circumstances.

11 Our second Panel will focus more  
12 specifically on how the Commission assesses  
13 initially, and on an ongoing basis, the adequacy  
14 of risk management and surveillance of new  
15 products. Panelists from the Commission's  
16 Division of Clearing and Risk, Swap Dealer and  
17 Intermediary Oversight and Enforcement will  
18 provide insight into how each of their divisions  
19 considers products that present novel or unique  
20 risk profiles, and how they go about developing  
21 the expertise necessary to accomplish their  
22 missions.

1                   Our third Panel features representatives  
2                   from DCMs and DCOs, who will discuss the  
3                   self-certification process from their perspective.

4                   Our fourth and final Panel will address  
5                   the question of novelty. The experts on this  
6                   Panel will discuss the question of novelty and  
7                   whether the current self-certification process  
8                   allows for adequate regulatory consideration when  
9                   a product is, itself, determined to be novel or  
10                  presents complex or unique issues.

11                  I am hopeful that today's conversation  
12                  will serve to educate the public on the success of  
13                  the self-certification process and, perhaps, shed  
14                  light on what lies ahead in the virtual currency  
15                  space. As market participants introduce new  
16                  virtual currency products in the months and years  
17                  ahead, I look forward to a broader conversation by  
18                  the Commission in considering what steps can be  
19                  taken to better evaluate novel products in a  
20                  transparent manner, and to bring all ideas,  
21                  concerns, and suggestions to best inform the  
22                  general public about our process of review. In my

1 view novelty is a fleeting concept which time  
2 consumes; but while novelty exists, it shines  
3 brightly and must be handled with care.

4           Everyone in this room plays a key role  
5 in the success of the derivatives market. We all  
6 have unique and often diverse interests,  
7 responsibilities, and duties; but we also have  
8 many common interests, not the least of which is  
9 the promotion and support of healthy, safe, and  
10 transparent derivatives markets.

11           As a regulator, I believe it is the  
12 Commission's responsibility to hold public  
13 meetings like these to educate; introduce fresh  
14 ideas; reconcile differences; and find solutions  
15 to new challenges so that market participants and  
16 the general public -- our number one constituent  
17 -- feels confident that we are fulfilling our  
18 responsibilities and can hold us accountable for  
19 our actions.

20           Although difficult at times, it is our  
21 responsibility to ensure we are constantly  
22 learning from past actions in seeking better

1 solutions to protect the public interest. I  
2 strongly believe this approach best serves all of  
3 us in the long run, and these markets continue to  
4 grow, innovate, and break barriers.

5 I want to thank, again, everyone for  
6 being here today; the MRAC Committee members; the  
7 speakers, Paul Architzel, Alicia Lewis,  
8 Commissioner Quintenz and, of course, Chairman  
9 Giancarlo; I look forward to the discussion.  
10 Thank you.

11 MS. LEWIS: Thank you all for your  
12 opening remarks. As Commissioner Behnam stated,  
13 Paul Architzel will facilitate and help shape  
14 today's discussions during our Panels. As noted  
15 in the agenda, the first Panel will be on the  
16 self-certification of products; and I'll turn it  
17 over to Paul.

18 MR. ARCHITZEL: Thank you, Commissioner  
19 Behnam and Ms. Lewis for the kind introduction;  
20 and for asking me to facilitate this meeting; it  
21 is an honor. Our task today is to examine the  
22 relationship of the Commission's product

1        permissioning processes and market risks. It is a  
2        substantial undertaking; but, hopefully, by the  
3        end of the day, we'll all have a clearer  
4        understanding of the issues.

5                    I'd note that the Commission has had  
6        three separate product permissioning systems  
7        during its history. First, prior approval of all  
8        newly-listed products was the process that was  
9        used from the time of the Commission's formation  
10       to about 1998. During a two-year process, there  
11       was a two-track system consisting of fast track  
12       for routine new product listings, and prior  
13       approval for novel products.

14                   Beginning in 2000, the current system of  
15       self-certification or voluntary exchange requests  
16       for prior approval was in place. It should be  
17       remembered that whatever process has been in  
18       place, the Commission has had an enviable place  
19       among regulators of fostering innovation in the  
20       market that it regulates. During its tenure, the  
21       Commission has overseen the introduction of  
22       financial futures, exchange traded options, stock

1 index contracts, and other new asset classes.  
2 There's been much debate accompanying each of  
3 these new introductions of new asset classes. It  
4 may be that today's discussion is part of that  
5 history.

6 Finally, on a personal note, I would  
7 have to make clear that my appearance today is on  
8 my own behalf, and any views that I express are my  
9 own.

10 Before starting our first Panel, there  
11 are a few logistical items that I've been asked to  
12 mention to the Committee members and invited  
13 speakers. Please make sure that your microphone  
14 is on when you speak. This meeting is being  
15 simultaneously webcast, and it is important that  
16 your microphone is on so that the webcast audience  
17 is able to hear you. Also, if you would like to  
18 be recognized during the discussions, please  
19 change the position of your placard so that it is  
20 vertical on the table, or raise your hand, and Ms.  
21 Lewis will recognize you and give you the floor.

22 Finally, although I'm facilitating the

1 meeting, the purpose of MRAC is for members of the  
2 Committee to be able to discuss the issues; ask  
3 each other questions; and ask the Panelist  
4 questions; so, please don't hesitate to raise your  
5 issues during the course of the meeting.

6 Our first Panel, as it's been said, are  
7 the division directors of the Commission We have  
8 with us Dan Davis, General Counsel in the Office  
9 of General Counsel; we have Amir Zaidi, the  
10 Director of the Division of Market Oversight; and  
11 Brian Bussey, who is the Director of Clearing and  
12 Risk. With that, I'll turn it over to them for  
13 their opening statements.

14 MR. DAVIS: Thank you. I'm Dan Davis,  
15 General Counsel of the CFTC. It's a pleasure to  
16 be here today. I want to thank Commissioner  
17 Behnam and Ms. Lewis for the opportunity to speak.  
18 I always enjoy the opportunity to speak in public  
19 in front of my bosses; so, thank you for that.

20 I'll issue the standard disclaimer both  
21 for myself and for all CFTC staff who will speak  
22 today. We are, of course, are here; we do not



1 speak on behalf of the Commission; and that our  
2 views that we express are not necessarily the  
3 views of the Commission, the Chairman, or the  
4 Commissioners, or the agency, as a whole.

5 As Paul alluded to -- I want to thank  
6 him for moderating, as well -- my role in my  
7 statement is to give a very brief history of the  
8 regulation and the self-certification process. As  
9 Paul noted, the main demarcation point for  
10 self-certification is the Commodity Futures  
11 Modernization Act of 2000 which introduced  
12 self-certification to the Commission. Prior to  
13 that time, it was a very different process at the  
14 Commission. If you were seeking a product  
15 approval, you would be relying on a process that  
16 had been in place since the Grain Futures Act of  
17 1922. Under that regime, a board of trade had to  
18 submit every single contract for approval to the  
19 Commission; and that there had to be a Commission  
20 action to approve that particular product.

21 Now, over the years, there were various  
22 factors that the Commission considered when it was

1       engaging in that product approval process. Some  
2       were broader than others; but, probably, the  
3       broadest factor was one that was included in 1974,  
4       which required the Commission when it was  
5       considering whether to approve a contract, whether  
6       that contract would not be contrary to the public  
7       interest. As a lawyer, a public interest standard  
8       is, relatively speaking, a quite broad standard  
9       and it would allow a commission to consider all  
10      sorts of factors -- basically any type of pro and  
11      con -- with respect to the acceptance or approval  
12      of a particular product.

13                 In addition, under the regime, prior to  
14      the CFMA, there was no time limit, whatsoever, for  
15      the Commission to accept or reject a product; so  
16      there was no statutory or regulatory deadline  
17      requiring the Commission to act in any certain  
18      timeframe.

19                 The rule approval process was similar in  
20      many ways. It also required Commission approval;  
21      although the rule approval process -- depending on  
22      what time period you were working in -- involved

1 different types of deadlines. During some periods  
2 of time, there was a 30-day period for review. In  
3 1978, Congress added a requirement that the  
4 Commission could take some additional time; they  
5 could take 60 days to review a rule if it involved  
6 something of major economic significance; and in  
7 that circumstance, it also required a public  
8 comment period.

9           So, the pre-CFMA process was subject to  
10 Commission approval-- relatively speaking -- a  
11 number of broad standards and considerations that  
12 the Commission had to consider; and with products,  
13 no time limits and with rule approvals, varying  
14 time limits, depending on the time period and,  
15 specifically, the statutory regime that you were  
16 in at that time.

17           That, of course, all changed with the  
18 CFMA, which introduced self-certification to the  
19 process; and there were a couple of key changes  
20 that were made with the CFMA. The first, I think,  
21 is the standard of review. For both products and  
22 rules, the basic inquiry that the Commission was

1       supposed to make was for products -- would the  
2       product violate the CEA and its regulations; and  
3       for a rule, would that rule be inconsistent with  
4       the CEA and the regulations.

5                 Now, of course, the self-certification  
6       process allowed registered entities to make that  
7       determination for themselves, in the first  
8       instance, and allowed registered entities to make  
9       a submission to the agency stating that in their  
10      view the particular product, or the particular  
11      rule that was seeking to be approved, was  
12      consistent with or didn't violate the CEA and its  
13      regulations. So, it's a narrower standard than  
14      the pre-CFMA regime.

15                There were also time limits that were  
16      placed, specifically in the CEA, about rule  
17      submissions; and a lot of those were added as part  
18      of the Dodd Frank Act. We're not talking as much  
19      about rule submissions today, but there were some  
20      time limits added there. There was for the  
21      product approval process if an entity decided to  
22      elect a product approval process with the

1 Commission as opposed to the self-certification  
2 process, there were some time limits that applied  
3 there.

4 Now, with the CFMA coming into play in  
5 2000, the Commission, of course, has promulgated  
6 regulations with respect to both product  
7 self-certification and rule self-certification.  
8 Those rules have been modified a few times. The  
9 product self-certification, which is found in 40.2  
10 -- it's adopted originally in 2001 -- it's been  
11 modified twice since that time.

12 Under the current regime -- under 40.2  
13 for self-certification of products -- when a  
14 registered entity certifies that a product  
15 complies with the CEA and its underlying  
16 regulations, it can list that product for trading  
17 the next business day. That is not a specific  
18 time requirement that is stated in the CEA itself,  
19 but it is the regulatory requirement that has been  
20 imposed by the Commission.

21 There are two circumstances under which  
22 a self-certification for a product can be stayed

1 by the Commission; and those are laid out in 40.2.  
2 That is, if the Commission has begun a proceeding  
3 for false certification, asserting that there is  
4 some false element of the self-certification  
5 itself, or if the Commission has invoked Section  
6 8a(7) of the Act which allows the Commission to  
7 impose new terms and conditions -- or new rules --  
8 on the registered entities. And, so, in those two  
9 circumstances, that's when the regulation allows  
10 the Commission to stay self-certification of a  
11 product.

12 The prior approval process for products  
13 is found in Part 40.3. That allows a longer  
14 period of time for the Commission to review -- a  
15 45-day period which can be extended for an  
16 additional 45 days if it involves a novel or  
17 complex issue; there's an inadequate explanation  
18 provided by the registered entity; or if the  
19 Commission determines that it is potentially  
20 inconsistent with the CEA.

21 There are similar provisions for rules  
22 -- both self-certification for rules, and prior

1 approval for rules. For self-certification for  
2 rules, which is found in 40.6, a rule is certified  
3 and takes effect within 10 business days unless  
4 the Commission decides to stay the rule. The  
5 Commission can stay the rule under 40.6 if it  
6 presents a novel or complex issue; there's an  
7 inadequate explanation given; or it's potentially  
8 inconsistent with the CEA.

9           The prior approval process for rules --  
10 that's found in 40.5 -- like the prior approval  
11 process for products, there's an initial review  
12 period of 45 days which can be extended by the  
13 Commission in certain circumstances.

14           So, that is a brief summary of the  
15 background with respect to the self-certification  
16 process; and I look forward to the discussion with  
17 the Committee regarding this process.

18           MR. ZAIDI: Good morning. Thank you for  
19 having me today. My name's Amir Zaidi. I'm the  
20 Director of the Division of Market Oversight; and  
21 today I will discuss the new product review  
22 process from a DMO's perspective.

1           While there has been much focus on the  
2 self-certification process these past few months,  
3 I think this discussion mostly misses the point.  
4 The real issue is the standards a DCM must meet  
5 when listing a new contract and whether those  
6 standards are appropriate. From DMO's  
7 perspective, we focus on Core Principle 3, Core  
8 Principle 4, Core Principle 5, among other  
9 requirements that go towards protecting the  
10 integrity of the futures market.

11           A lot has been thrown around the term  
12 readily susceptible to manipulation; but what does  
13 that actually mean? I'll give an overview of  
14 these standards today. When exchange  
15 self-certifies a new contract, it is asserting  
16 that the product complies with the CEA and the  
17 Commission's regulation.

18           Core Principle 3, as I said, requires  
19 that a DCM only list contracts that are not  
20 readily susceptible to manipulation.

21           Core Principle 4 requires that a DCM  
22 have the capacity and responsibility to prevent



1 manipulation, price distortions, and disruptions  
2 of the delivery and cash settlement process  
3 through market surveillance, compliance, and  
4 enforcement practices.

5 Core Principle 5 requires that DCMs  
6 adopt, as is necessary and appropriate, position  
7 limits or position accountability levels.

8 Now, under Core Principle 3, there are  
9 no rules; but the Commission has issued guidance.  
10 Guidance provides further detail for cash-settled  
11 products. It says cash-settled contracts may  
12 create an incentive to manipulate or artificially  
13 influence the data from which the cash settlement  
14 price is derived, or to assert undue influence on  
15 the cash settlement price's computation in order  
16 to profit on a futures position in that commodity.  
17 Careful consideration should be given to the  
18 potential for manipulation, or distortion of the  
19 cash settlement process, as well as the  
20 reliability of that price as an indicator of cash  
21 market values.

22 It also says when an independent,

1 private sector, third party calculates the cash  
2 settlement price series, a DCM should verify that  
3 the third party utilizes business practices that  
4 minimize the opportunity or incentive to  
5 manipulate that cash settlement price series.  
6 Such safeguards include lockdowns, prohibitions  
7 against derivatives trading by employees, or  
8 public dissemination of the names and sources and  
9 the price quotes they provide.

10           Because cash-settled contracts may  
11 create incentive to manipulate or artificially  
12 influence the underlying market from which the  
13 cash settlement price is derived, or exert undue  
14 influence on the cash settlement computation in  
15 order to profit on a futures position in that  
16 commodity, a DCM should, whenever practicable,  
17 enter into an information-sharing agreement with  
18 the third-party provider which would enable the  
19 DCM to better detect and deter manipulative  
20 behavior.

21           Under Core Principle 4, there are also  
22 requirements for cash-settled contracts. For

1 cash-settled contracts, a DCM must demonstrate  
2 that it monitors pricing to the index to which the  
3 contract will be settled; and monitors the  
4 continued appropriateness of the methodology for  
5 deriving the index; and makes a good faith effort  
6 to resolve conditions, including amending the  
7 contract terms, when necessary, where there's a  
8 threat of market manipulation, disruptions, or  
9 distortions.

10           If a contract listed on a DCM is settled  
11 by reference to the price of a contract or  
12 commodity traded in another venue, including the  
13 price or index derived from prices on another DCM,  
14 the DCM must have rules or agreements that allow  
15 the DCM to access information on the activities of  
16 traders in that referenced market. The DCM must  
17 have rules that require traders in its contracts  
18 to keep records of their trading, including  
19 records of their activity in that underlying  
20 commodity and related derivatives markets; and,  
21 also, make such records available upon request to  
22 the DCM. Appropriately, the guidance and rules

1 focus on protecting the cash settlement process  
2 and any index that the futures contract settles to  
3 from manipulation.

4 Much attention is spent by DCMs and the  
5 CFTC staff to ensure that the index is constructed  
6 in a way to prevent such manipulation. For  
7 example, DCMs and the CFTC staff look at the  
8 liquidity and number of transactions making up the  
9 cash settlement process if an outside trade could  
10 affect the settlement process and the convergence  
11 of cash and futures prices. This is appropriate  
12 because any manipulation could affect the futures  
13 market, and manipulators could, potentially,  
14 profit on futures market positions. Futures  
15 integrity is, obviously, squarely within the DCM's  
16 and CFTC's mandate. For DMO staff, in its review  
17 of products, it focuses on these contract-design  
18 issues like the construction of the cash  
19 settlement process.

20 However, it is not the responsibility of  
21 DCMs or the CFTC to oversee on a daily basis every  
22 cash commodity market or make suitability

1 judgments about the underlying commodity market  
2 and whether a futures contract should be able to  
3 be listed on it. Rightly, we are not overseeing  
4 cash markets and participants on a daily basis for  
5 abusive practices and risks. Every cash market  
6 underlying futures contracts can be manipulated.  
7 Gold, silver, FX, Bitcoin cash markets, they can  
8 all be manipulated. However, making detailed  
9 judgments about the level of manipulation,  
10 generally, in those cash markets, and if it is too  
11 little or too much to list a futures contract, is  
12 a different analysis from whether a futures  
13 contract is readily susceptible to manipulation.

14           Going down this road would be a huge  
15 expansion of our and DCMs' responsibility and  
16 jurisdiction, and is inconsistent with decades of  
17 precedent under the CEA. While we are attentive  
18 to the general manipulation concerns in the cash  
19 market, for example, through our enforcement  
20 authority, DMO's analysis of whether a contract is  
21 readily susceptible to manipulation from a futures  
22 contract listing standpoint, always ties back to

1 the integrity of the futures contract and the  
2 settlement process. That is why contract design  
3 issues are so important to ensure that cash  
4 settlement process cannot be manipulated through,  
5 as I said, outside trades or other factors.

6 In addition, DCMs and CFTC have the  
7 obligation to conduct surveillance on traders in  
8 the derivatives markets, and when deemed  
9 appropriate or necessary, make inquiries into the  
10 activities of the underlying cash markets. Again,  
11 this ties back to the futures market integrity.  
12 That is why our rules require DCMs to have rules  
13 that allow it to have access to information on  
14 activities of its traders in the referenced  
15 market.

16 Likewise, DCMs and the CFTC monitor  
17 prices in the derivatives market, vis-a-vis the  
18 cash markets, to identify potential manipulative  
19 behavior or to assess proper functioning of the  
20 derivatives contracts. This limited monitoring,  
21 as I said, all ties back to the futures contract  
22 and is appropriate to protect the integrity of the

1 futures contracts.

2           Questionable social utility and price  
3 valuations of a new asset class are not sufficient  
4 reasons for the CFTC to set regulatory policy  
5 based on personal value judgments however  
6 considerable the inherent risk associated with  
7 that new asset class. Moreover, to the extent  
8 that commercial interests agree that there is  
9 legitimate value in using the underlying asset,  
10 the CFTC should allow the introduction of  
11 derivatives on those assets for risk shifting and  
12 management purposes. Unless Congress decides to  
13 ban certain cash commodity trading, our job is  
14 simply to ensure that the futures contracts --  
15 based on those cash commodities -- including any  
16 cash settlement process, are not readily  
17 susceptible to manipulation.

18           Finally, rules under Core Principle 5  
19 that require that cash-settled contracts, DCMS'  
20 adopts spot month position limits that are no  
21 greater than necessary to minimize the potential  
22 from manipulation or distortion of the contracts

1 or the underlying commodity's price. The CFTC  
2 understands that the presence of position limits  
3 it reduces the ability and financial incentive for  
4 market participants to attempt to manipulate the  
5 contract or underlying cash markets. Thank you  
6 very much, and happy to answer questions after  
7 Brian goes.

8 MR. BUSSEY: Thanks, Amir. Thank you  
9 for having me speak today. As mentioned, I'm  
10 Brian Bussey, Director of the Division of Clearing  
11 and Risk. The focus of this Panel is on DCMs and  
12 SEFs, and the self-certification process; but I  
13 wanted to take a few minutes to talk about the  
14 Division of Clearing and Risk and new products  
15 from a process prospective. You have the good  
16 fortune of having me on the second Panel, as well,  
17 where I'll talk more from a risk perspective --  
18 the approach that we take in clearing and risk on  
19 new products.

20 While DCMs and SEFs are required to file  
21 a certification under Regulation 40.2 before  
22 listing a new product for trading, derivatives



1 clearing organizations are only required to file a  
2 certification under a separate regulation --  
3 Regulation 40.6, which generally covers any new  
4 rules or rule changes only if a rule change is  
5 required before clearing of the product can begin.

6 As you probably know, many new products  
7 do not require new clearing rules or clearing rule  
8 changes. So, oftentimes, we do not receive formal  
9 certifications under Regulation 40.6 for new  
10 products. In the event a new rule or rule change  
11 is necessary, a DCO will typically provide draft  
12 copies of the certification in advance of the  
13 formal filing under Regulation 40.6; and this is  
14 particularly the case for significant rule  
15 changes. This allows the staff, on an informal  
16 basis, to ask questions, seek additional  
17 information, and provide feedback before the  
18 formal filing. Once that filing occurs under  
19 40.6, there's a 10-day period, and 40.6 gives the  
20 Commission the ability to stay the 10-day period,  
21 giving the Commission an additional 90 days during  
22 which to consider the filing; and we're also

1 required to do a 30-day public comment period  
2 under Regulation 40.6. But, again, this process  
3 is only required when there is a new clearing rule  
4 or a clearing rule change that's required for a  
5 new product.

6 Even when the proposed clearing of a new  
7 product does not require a filing under Regulation  
8 40.6, there are usually informal discussions  
9 between DCR staff and the DCO when a DCO plans to  
10 clear a new product; and this is particularly the  
11 case when the new product is novel or complex.  
12 During these discussions DCR staff may, and often  
13 does, request that the DCO provide certain data  
14 and background information. How extensive these  
15 discussions are and how far in advance they take  
16 place depends on how novel or complex the product  
17 is.

18 Finally, I wanted to touch briefly on  
19 Regulation 40.10. Under Regulation 40.10, as many  
20 of you know, a DCO that has been designated as  
21 systemically important by FSOC, something that we  
22 call a SIDCO must give 60-days advanced notice of

1 any proposed changes to its rules, procedures or  
2 operations that could materially affect the nature  
3 or level of risk presented by the SIDCO. The  
4 regulation further defines materially affect the  
5 nature or level of risk presented as matters as to  
6 which there is a reasonable possibility that the  
7 change could affect the performance of essential  
8 clearing and settlement functions or the overall  
9 nature or level of risk presented by the SIDCO.

10 As of now, we only have two SIDCOs.  
11 Those are CME and ICE Clear Credit; but the OCC,  
12 the Options Clearing Corporation, and our other  
13 DCOs are not SIDCOs; so they would not be subject  
14 to the 40.10 process.

15 Historically, DCR staff has not viewed  
16 the clearing of a new product standing alone as a  
17 change that could materially affect the nature or  
18 level of risks presented by a SIDCO. DCR has  
19 reviewed new products pursuant to Regulation 40.10  
20 in the past; but when it has done so, it has been  
21 in combination with a new margin methodology or  
22 changes to an existing margin methodology, or

1 other changes to risk management involved with the  
2 introduction of the new product.

3           Growth in the clearing of new products,  
4 as you know, is typically quite slow, allowing DCR  
5 to monitor the risk management of the products in  
6 greater depth over time -- something that we'll  
7 talk about on Panel 2. Bitcoin is an example of  
8 that. After six weeks, we have open interest of  
9 around 40 million at each of the two  
10 clearinghouses clearing the Bitcoin futures; and  
11 again, as you all know, \$40 million for OCC or CME  
12 is a very tiny fraction of the overall open  
13 interest at those two DCOs. And with that, I will  
14 turn it back over to Alicia and Paul to continue  
15 to moderate the Panel.

16           MR. ARCHITZEL: Thank you; that was very  
17 enlightening. One of the topics that Mr. Bussey  
18 mentioned was about the informal review processes  
19 that take place around new products or new rules;  
20 and I'm wondering if maybe we could have a little  
21 bit more of a discussion about what those informal  
22 processes are; how people know about them; whether

1       there should be more formal processes; what are  
2       the relative merits of a formal vs. an informal  
3       process pre-certification.

4                   I think that would be something for the  
5       Panel and perhaps the Committee also would like to  
6       discuss the relative merits of a formal vs.  
7       informal processes; and maybe starting with the  
8       Panel discussing what the informal processes are  
9       how they operate.

10                   MR. BUSSEY: So, the formal part of the  
11       process for a new product is the 40.2 process  
12       through the Division of Market Oversight. As I  
13       said, in most cases, new products do not require a  
14       formal process on the clearing side; so, there's  
15       not a formal process for Commission notice on the  
16       clearing side when there's not a rule filing. Of  
17       course, DCOs -- and I'll allow them to speak for  
18       themselves -- oftentimes talk with their  
19       membership, their risk committees, and so forth as  
20       part of their governance process to discuss the  
21       launch of new products. That's something that is  
22       done separate and apart from the regulatory

1 process here at the Commission.

2 In terms of the actual process that we  
3 go through, again, it depends on the nature of the  
4 product. For relatively routine submissions,  
5 there's not very much process -- the next wheat  
6 contract is not something that will generate a lot  
7 of focus in the Division of Clearing and Risk.  
8 Instead, we deal with those products more on an  
9 ongoing basis through our risk surveillance  
10 efforts. For more novel and complex products, the  
11 process, again, informal, but involves outreach by  
12 the DCO to us, or my colleagues in DMO talking  
13 with us about a new product and resulting in  
14 outreach to the DCO to discuss the risk management  
15 of the product.

16 For the sake of time, Paul, that  
17 process, I can certainly talk about here, but we  
18 were going to talk more about that in Panel 2 in  
19 terms of what our risk focus is. If you'd like me  
20 to do a bit of a preview here, that would be fine.

21 MR. ARCHITZEL: No; I think maybe we can  
22 talk about the informal process in DMO for new

1 product approvals and certifications.

2 MR BUSSEY: Sure.

3 MR. ZAIDI: Like Dan said, it's more of  
4 a formal process either through the  
5 self-certification or approval, but for  
6 self-certification most contracts, as all of you  
7 should know, that really don't trade have any  
8 volume; so, we're not necessarily looking at every  
9 single product that comes in, but when there is  
10 something unique -- such as the recent Bitcoin  
11 contracts -- exchanges and DMO have very good  
12 relationship so they come in; talk to us about  
13 those products; we see draft terms and conditions  
14 -- just like the recent processes, we spent  
15 several weeks and months talking to the exchanges  
16 about the contract and seeing draft terms and  
17 conditions; talking about issues; making  
18 improvements, so that's generally how the process  
19 goes for kind of through the self-certification  
20 process.

21 Like I said, at the end of the day,  
22 exchanges will take care of any issues that we

1 raise, just like they did in this situation, and  
2 we were comfortable with the products at the end  
3 of the day.

4 MR. DAVIS: And just from an OGC  
5 perspective, obviously, we don't review every  
6 product that comes in either. We await word from  
7 DCR and DMO. If there are any particular legal  
8 questions or particular concerns about a  
9 particular product and we'll discuss those as  
10 those issues arise.

11 MR. ARCHITZEL: So, I guess, a follow-up  
12 question would be -- what are the benefits of an  
13 informal vs. a formal process. Is it possible  
14 under the statute to make more formal the process  
15 which is operating as an informal process now?  
16 And that may be something that members of the  
17 Committee have a view or questions on as well.

18 MS. LEWIS: The Chair recognizes Bis.

19 MR. CHATTERJEE: Hi; good morning.  
20 Thank you, Alicia, for the opportunity; and thank  
21 you for the Chairman, sponsor, and for  
22 Commissioner Quintenz. I'd like to, first of all,



1 say that, you know, as a market participant, we  
2 fully acknowledge and support the  
3 self-certification process because it's led to  
4 tremendous innovation in products, which is  
5 something the market needs. The one question, you  
6 know, I would like to ask the Panel is, especially  
7 maybe, you know, Amir -- the DMO -- you mentioned  
8 that it's probably impossible to surveil every  
9 underlying cash product; and it's kind of  
10 completely beyond the mandate that the DMO  
11 currently has; and your mention about the  
12 underlying informal dialogue with the exchanges of  
13 the DCMs listing new products -- what part of the  
14 dialogue focuses on the fact that the underlying  
15 product itself -- the cash product itself -- may  
16 be in a relatively new state of maturity in the  
17 marketplace or with the nature of the participants  
18 that play in it; or could you shed some light if  
19 that discussion also focus on the fact that the  
20 underlying cash product itself may not be  
21 regulated currently?

22 MS. LEWIS: May I remind everyone to

1 just please speak into the mic, so that we can  
2 hear you.

3 MR. ZAIDI: Sure; thanks for the  
4 question. Like I said in my remarks, we do take  
5 into account the underlying cash market; but it's  
6 historical practice has been really to focus on  
7 the contract design and how the -- for example, in  
8 this case -- the index is constructed for the cash  
9 settlement process to ensure that the futures  
10 contract is not readily susceptible to  
11 manipulation. So, there are things that you can  
12 do with constructing the index, as you know,  
13 adding more cash market platforms, transactions to  
14 make sure that the product is liquid; making sure  
15 that certain outside trades don't have an  
16 influence during that settlement process; looking  
17 at kind of collars around those settlement prices  
18 to ensure that the settlement price is not too  
19 outside of the index.

20 So, those are things that our product  
21 review group in DMO focuses a lot with the  
22 exchanges -- that's what we did in this process

1 for the Bitcoin futures contracts. As you know,  
2 our surveillance division and CFTC has general  
3 fraud and manipulation authority in the cash  
4 market; but from our purposes for DMO, we're  
5 mostly focused on how that settlement process is  
6 constructed tying back to the futures market  
7 integrity, like I said; and, as I mentioned as  
8 well, there are other safeguards in place as far  
9 as monitoring; and some of the monitoring that the  
10 exchanges are doing of their futures market  
11 participants; and their positions in the cash  
12 market; so they're not, potentially, going into  
13 the cash market to manipulate to affect futures  
14 prices. So, that's really, historically, what  
15 we've been focused on; and that's kind of in line  
16 with what we've done in the enhanced review  
17 process.

18 MS. LEWIS: The Chair recognizes  
19 Kathleen Cronin.

20 MS. CRONIN: Yeah. One observation I  
21 just want to make specifically with respect to the  
22 question on the formal vs. an informal review

1 process with the Commission staff. I think that  
2 CME is very cognizant of the fact that if we're  
3 listing a new product that's unique or has  
4 different characteristics from what's currently  
5 listed, that it's important for us to make sure  
6 that the Commission is not surprised by that  
7 filing and that the staff is comfortable with what  
8 we're doing; and, from my perspective -- and I  
9 think from what I'm hearing from the staff -- that  
10 informal process has worked well over the years.

11 To impose a formal process, I think,  
12 unnecessarily creates administrative burdens that  
13 aren't necessary in connection with the listing of  
14 new products. If it's worked so far and there  
15 haven't been any problems, I think the creation of  
16 formal processes will just impose more burdens on  
17 the staff and impose more burdens on the exchange  
18 to comply with formalistic requirements that  
19 aren't necessary in connection with listing a  
20 particular new contract.

21 MS. LEWIS: The Chair recognizes Marnie  
22 Rosenberg.

1                   MS. ROSENBERG: Thank you, Alicia;  
2                   Marnie Rosenberg from J.P. Morgan. Thank you to  
3                   Commissioner Behnam, and Chairman Giancarlo, and  
4                   Commissioner Quintenz for your opening remarks.  
5                   One thing that I think would be very helpful --  
6                   and I would direct this to Daniel or Brian -- is  
7                   in the context of the different rule provisions  
8                   that you outlined for self-certification and for  
9                   approvals -- in which circumstances is there any  
10                  kind of mandatory public comment period? I think  
11                  just kind of that overview would be very helpful.

12                  MR. DAVIS: So, I think, as I mentioned  
13                  in my remarks, in 40.2, which is the  
14                  self-certification for products, there is no --

15                  MS. LEWIS: Dan, I'm sorry, can you  
16                  speak into the mic?

17                  MR. DAVIS: Sorry. There is no  
18                  regulatory provision in 40.2 for public comment.  
19                  There is the availability for public comment both  
20                  in prior approval for products and prior approval  
21                  for rules. Those are provisions that can be  
22                  extended up to 90 days; and so, in that 90-day

1 period, there is sufficient time to have a public  
2 comment process.

3 MR. BUSSEY: And then in 40.10, there is  
4 not a provision in the rules or in the underlying  
5 statute, which is Title VIII of the Dodd Frank Act  
6 for a comment period; although, just recently, we  
7 did a comment period for a 40.10 filing; the first  
8 time we've ever done that.

9 MS. LEWIS: Kathleen, do you have  
10 another question?

11 MS. CRONIN: No; sorry.

12 MR. ARCHITZEL: Okay; perhaps we can  
13 talk a little bit about the yardstick that the  
14 Commission uses in reviewing those contracts which  
15 have been self-certified. Amir, you talked about  
16 the fact that you have guidance that you look to  
17 towards seeing whether or not a new contract meets  
18 Core Principles 3, 4, and 5; and, I think that's  
19 found as an appendix to Part 40, and it's a  
20 rewrite of the old Guideline No. 1. I don't think  
21 that's been updated for many years and, I think,  
22 one question might be is the guidance that is put

1 out that you look at current and would it be  
2 beneficial to have that be updated?

3 MR. ZAIDI: Sorry; are you talking about  
4 the guidance under Part 38 or Part 40?

5 MR. ARCHITZEL: Yeah, sorry.

6 MR. ZAIDI: Okay. Yeah; so, under, like  
7 I mentioned, Core Principle 3, there are no rules  
8 but the Commission published Guidance to Part 38,  
9 outlining what it looks for if a contract is  
10 readily susceptible to manipulation. I'm not  
11 exactly sure when the Guidance was last updated,  
12 but I know during the DCM rule proposal and final  
13 rule during Dodd Frank back in 2012, 2013, the DCM  
14 rules were updated so it's possible that the  
15 Guidance was looked at, at that point.

16 The Guidance, as many of you probably  
17 know, is general. It doesn't make a distinction  
18 between certain contracts vs. other contracts.  
19 It's something that we have been looking at  
20 recently; but we haven't made any decisions as far  
21 as if it needs to be updated or what parts of it  
22 may need to be updated. So, that's something that

1       could possibly be looked at.

2                   MS. LEWIS:  The Chair recognizes Kristen  
3       Walters.

4                   MS. WALTERS:  Thank you; and thanks for  
5       including me in this forum.  Just a question -- so  
6       I understand that when we talk about new products  
7       that the focus is on the contract design, index  
8       construction, settlement on the exchange, and I  
9       certainly think that makes sense in the context of  
10      traditional financial assets and/or underlying  
11      commodities.

12                   I guess, just would like to understand  
13      the views -- in looking at the research and views  
14      from central bankers, my firm, risk managers, on  
15      the risk associated with Bitcoin, most of the  
16      dialogue is around the fact that Bitcoin and other  
17      cryptocurrencies are a very small component of  
18      financial markets in general, thus no concern from  
19      impact on monetary policy, or on financial markets  
20      -- but just given the rapidly involving nature of  
21      cryptocurrencies in general, and the underlying  
22      nature of the asset; so, from my perspective, it's



1 not clear if cryptocurrencies are currencies;  
2 commodities; securities; if they provide value;  
3 and there are some significant challenges around  
4 valuation.

5           So you have an asset that has no cash  
6 flow, no earnings, no interest rate -- extreme  
7 volatility, even in the market cap of these  
8 currencies -- and with very, very large  
9 assumptions that need to be made to even consider,  
10 like a value. So, I guess the question is, with  
11 that backdrop and for this specific type of  
12 product, at what point would you think it might be  
13 necessary to move from an informal process towards  
14 something more formal as this type of product  
15 evolves?

16           MR. ZAIDI: Like I said in my remarks,  
17 things about risk, people's perceptions of value  
18 of Bitcoin or other commodities are not  
19 necessarily something that we are looking at in  
20 the product review futures contract listing  
21 process. What our statute provides is to look  
22 whether that contract is readily susceptible to

1 manipulation. So that's what we are focused on.

2 If that's something -- that road -- we  
3 want to go down about making risk judgments or  
4 value judgments of just the underlying -- although  
5 DCR looks at risk from a DCO's perspective -- if  
6 we're going to look at risk or trying to determine  
7 if the price of Bitcoin or other cash virtual  
8 currencies are appropriate, I think that takes us  
9 down a dangerous path.

10 MS. WALTERS: Yes; actually, I  
11 understood your opening remarks, and what you  
12 said; I guess from my perspective, given the  
13 nature of this product, which is very different  
14 than anything that we've seen cleared on futures  
15 markets, like I feel like it's dangerous not to go  
16 down the path. So, at the current point, you  
17 know, the market cap is 500 billion to 800 billion  
18 of these cryptocurrencies with like massive  
19 volatility and very significant lack of clarity  
20 around some of the major risks. So, I understand  
21 that given its small today, that argument makes  
22 complete sense and it's consistent with your rules

1 and how you oversee the markets. I guess my  
2 question was intended to get you to speak about if  
3 the size of Bitcoin and cryptocurrency in  
4 financial markets starts to increase where it is  
5 significant, would that not be something that you  
6 would need to think about? So, actually, if you  
7 have an asset that you can't value; if it has no  
8 cash flow; if you can't even categorize what the  
9 asset physically is; at what point would you take  
10 a look at the CFTC's rules and, perhaps, evaluate  
11 that issue?

12 MR. BUSSEY: You know some of the issues  
13 in your initial remarks are issues that the risk  
14 group in Division of Clearing and Risk looked at  
15 in their discussions with the Options Clearing  
16 Corporation and CME. So, we took some of those  
17 issues into account -- the length of time that the  
18 underlying has been trading; the time series that  
19 we have available for doing back testing; and  
20 other analysis; and then on a going forward basis,  
21 we've been monitoring this product, even with the  
22 very small amount of activity in the product, and

1 the small amount of open interest, we've been  
2 focusing on it very intently. But from a DCR  
3 perspective, you would need to, I think, make some  
4 significant changes to the front-end process if  
5 you wanted to do that type of analysis on a formal  
6 basis, potentially even requiring a statutory --

7 MS. LEWIS: Brian, could you please  
8 speak into the mic?

9 MR. BUSSEY: Sure. Potentially even  
10 involving a statutory change; and, you know, part  
11 of the challenge, and we were facing Bitcoin in  
12 late October, early November, up to the launch not  
13 sure how big it's going to be, and it turns out  
14 it's -- thus far -- not been really a significant  
15 product. So, it's this question of balancing  
16 between -- to CME's comments earlier -- balancing  
17 between informal processes and more formal  
18 processes, not knowing what the future holds; but  
19 we're not done.

20 You know, we did our work leading up to  
21 the self-certification at the beginning of  
22 December, but Bill Heitner, who's going to be

1 speaking on the next Panel with me, his team in  
2 Chicago is focusing on this on a daily basis and  
3 considering risk issues in this product, keeping  
4 on top of it.

5 MR. ARCHITZEL: And I think the next  
6 Panel will talk a little bit more about  
7 post-launch, but for pre-launch, I guess, one, as  
8 a follow-up to your question -- one issue would be  
9 what does the statute permit and what flexibility  
10 does the agency have to vary the current processes  
11 that are in place; and do you see any possibility  
12 for having different processes pre-launch, or what  
13 you have required by the current statute.

14 MR. DAVIS: I'm not going to give  
15 definitive advice in this forum, but I will say  
16 that those are issues that we are looking at.  
17 Obviously, 5c(c) says what it says, and we're  
18 bound by those terms; and so, we are looking into  
19 questions as to what flexibility there is within  
20 5c(c) with respect to time frames; with respect to  
21 standards for thinking about stays, with respect  
22 to any type of pre-certification process. As, I

1 think, as both the Chairman and Commissioner  
2 Behnam noted, that is something that we, in OGC,  
3 are evaluating at this time and, obviously, we  
4 appreciate forums like this where we can get ideas  
5 from the Committee about what they think might be  
6 possible options in that realm.

7 MS. LEWIS: The Chair recognizes Marcus  
8 Stanley.

9 MR. STANLEY: Thank you; just a couple  
10 of questions based on some things that have come  
11 up in this discussion -- so, the first one to  
12 Brian. It appeared that you were saying that  
13 under the 40.10, Title VIII process you had kind  
14 of a general policy that new products would not be  
15 a change that would require advanced notice, that  
16 they would not be a change in procedure or  
17 operations that even could materially affect the  
18 nature and level of risks presented by the SIDCO.  
19 And I just wanted to ask -- I mean given that the  
20 introduction of a new product, it may have a small  
21 amount of trading initially, but the fact that the  
22 new product has been introduced could mean that

1 further down the road, there could be significant  
2 changes in the nature of level of risks that would  
3 not be accompanied by any change in the rules, or  
4 any other change that would require a 40.10  
5 review; so, isn't that, an initial introduction of  
6 the new product potentially your only chance to  
7 apply the intent of Title VIII to ensure a CFTC  
8 --and I would add, Federal Reserve -- review of  
9 the risks presented by a clearinghouse? So, I'll  
10 let you answer that first.

11 MR. BUSSEY: Sure. I mean, first off,  
12 as I pointed out it's -- in this context of  
13 Bitcoin futures -- it would only have been CME and  
14 not the OCC that would have been subject to 40.10.  
15 So, even if we thought it was the right thing to  
16 do to invoke 40.10, or if we could have invoked  
17 40.10, it would have only been a process that  
18 applies to CME, not to the OCC, and not to what 14  
19 of our 16 currently- registered DCOs. It's only 2  
20 of 16 that are registered as SIDCOs. And I think  
21 -- more specifically to your question -- it's not  
22 in no circumstance would we invoke 40.10 for a new

1 product. Our practice has been when it has been  
2 combined with an actual change to the rules, or to  
3 operations, or procedures.

4 In the case of CME -- when we looked at  
5 this, CME indicated to us that they did not  
6 require a rule change to launch the product. We  
7 had discussions with them; we checked on that; and  
8 we agreed that there was no rule change that was  
9 required in terms of operations and procedures.  
10 They proposed to use their existing margin  
11 methodology without changes either to their margin  
12 methodology or to their existing risk management  
13 practices. So, not saying definitively, but I  
14 think it would be hard to find a change there that  
15 would warrant 40.10; but then going back, 40.10 is  
16 not an across-the-board solution even if we were  
17 to invoke it for new product launches of the type  
18 that Bitcoin futures represented where there were  
19 no rule change; no change in margin methodology;  
20 no change in other risk management practices.

21 In contrast, I think swaptions -- the  
22 introduction of swaptions by CME was an example --



1 where we did invoke 40.10 that involved change to  
2 their margin methodology, and so we focused on  
3 that as a 40.10 because it was both a new product  
4 combined with a change in their proposed margining  
5 approach for that new product.

6 MR. STANLEY: I guess I'd say that when  
7 you apply an existing margin methodology to a very  
8 new product, that could be an effective economic  
9 change in what that methodology is really doing or  
10 the risks posed by it.

11 I guess the other question just to Mr.  
12 Zaidi -- I just wanted to be clear on the position  
13 that you were taking that it seemed in your last  
14 response to Ms. Walters and also to the gentleman  
15 from Citibank that you were taking a very strong  
16 position that statute restricted you to just  
17 looking at whether a contract is susceptible to  
18 manipulation and that asking the question of the  
19 relationship between the contract and the  
20 underlying, or whether there were fundamental  
21 weaknesses in the market for the underlying would  
22 take you, as you put it, down a dangerous path and

1 that you simply almost felt that you couldn't look  
2 through to the underlying, is that --

3 MR. ZAIDI: Right; so like I said,  
4 that's where the statute focuses on; that's where  
5 our guidance has focused on. Historically, the  
6 practice has been for DMO to look at that  
7 settlement process and how the index is  
8 constructed; how the futures contract is  
9 constructed. It all ties back to the futures  
10 market, obviously, because that's what we have  
11 jurisdiction over. So, just making the point that  
12 to broaden that jurisdiction now, going to looking  
13 at more and more in the cash market is just  
14 something that we should really think about before  
15 we go down that path.

16 MS. LEWIS: We're going to take two last  
17 questions, and then we're going to break. The  
18 Chair recognizes Dale Michaels.

19 MR. MICHAELS: Thank you; and the  
20 Options Clearing Corporation, we do clear the CBOE  
21 futures contract; but I'd make sure that the  
22 Committee also recognizes and doesn't confuse the

1 terms of formal vs. informal, and shallow vs.  
2 thorough, because the things that the CFTC did  
3 here was a thorough research of the product. We  
4 had many conversations with the CFTC, along with  
5 our risk committee -- and I'll talk about this  
6 more on the third Panel to give a bit more  
7 transparency to the governance process; but there  
8 was a great deal of research done; looking at the  
9 modeling of the Bitcoin product with the cash;  
10 looking how the margins; and looking at the back  
11 testing, how the models would react to the Bitcoin  
12 product. It was taken into account, going back to  
13 times when the Bitcoin was even more volatile than  
14 it was now. This led to a lot of discussions; a  
15 lot of information sharing with the CFTC; a lot of  
16 discussions around the overall risk management  
17 characteristics, and whether the models could  
18 handle it, whether the stress testing could handle  
19 it; so, we made sure that -- the fact that it is  
20 an informal vs. formal does not mean that it's not  
21 a thorough process that is being done, or at least  
22 has been done, from what I could see from the

1 Bitcoin product when we were looking to clear it.

2 MS. LEWIS: The Chair recognizes  
3 Kathleen Cronin.

4 MS. CRONIN: I'll make my comments  
5 brief, so that we can then go to the break. A  
6 couple of observations with respect to Bitcoin and  
7 the comments that have been made with respect to  
8 the novelty of the product -- there's no doubt  
9 that Bitcoin is relatively new; although it's been  
10 around for a number of years, but is the subject  
11 of increasing focus. I think it's important,  
12 though, to remember that what we have listed is a  
13 futures contract on a commodity that's cash  
14 settled to an index. So, in connection with that,  
15 we have all the protections in place that you have  
16 with respect to a regulated futures contract to  
17 minimize volatility and ensure that we have the  
18 appropriate margining to address any risk that's  
19 posed. And similar to any of our other contracts,  
20 after a product begins listing, the risk profile  
21 can change significantly, and that's addressed  
22 through the protections we have in place and

1 through the appropriate margining of the contract.  
2 So, to that extent, this contract is not that  
3 different from other contracts that have  
4 demonstrated volatility in the past. Thank you.

5 MS. LEWIS: At this time, we'll take a 5  
6 minute break. Thank you to the Panelists.

7 (Recess)

8 MS. LEWIS: It's my pleasure to call the  
9 meeting back to order. And now we will have the  
10 second panel, new products from a risk perspective  
11 and I will turn it over to Paul.

12 MR. ARCHITZEL: Hi. So the second panel  
13 we have four panelists. They will each give a  
14 short introduction of themselves. We have Brian  
15 Bussey who is the director of DCR, we have Bill  
16 Heitner also from DCR, Matt Kulkin the director of  
17 DSIO and Jamie McDonald the Director of Division  
18 of Enforcement. So with that I will turn it over  
19 to them, they each have a statement to make to  
20 start with.

21 MR. BUSSEY: Thank you, Alicia and Paul.  
22 You get the benefit of seeing me again and hearing

1 me again speak. This is Brian Bussey from  
2 Division of Clearing and Risk. The commission has  
3 a range of tools that address the risk management  
4 and oversight of cleared products. Specifically  
5 there are many requirements under the Commission's  
6 regulations related to risk management at both the  
7 DCO and clearing member level.

8           Among others, regulation 39.13 contains  
9 risk management requirements for DCO's, addressing  
10 among other things margin requirements and margin  
11 models, back testing and stress testing.  
12 Regulation 39.19 requires DCO's to report to the  
13 Commission on a daily basis, initial and variation  
14 margin, other cash flows and end of day positions.  
15 As Bill Heitner to my left, DCR's head of risk  
16 surveillance, will discuss shortly staff and risk  
17 surveillance use this information to perform daily  
18 risk surveillance among other oversight, tasks.  
19 And I just want to stress coming off the first  
20 panel, the certification process in DMO and the  
21 informal process that DCR often takes with respect  
22 to new products is not the end of the process. It

1 is just the beginning and Bill will detail a lot  
2 of the work we do on a daily basis once a product  
3 has been launched to monitor the risk, the risk at  
4 the DCO, buildup of risk at clearing members and  
5 at the individual large trader level.

6 And then there is regulations 1.73 and  
7 23.609. These are risk management requirements  
8 for FCMs and swap dealers that are clearing  
9 members including among other things requirements  
10 for stress testing and liquidity testing. This is  
11 ongoing work that we do and ongoing requirements  
12 that clearing members have to address risk in the  
13 clearing system. From a process perspective, the  
14 division's oversight efforts with respect to new  
15 products break down into pre and post launch  
16 activities. Again risk surveillance is a key part  
17 of that which Bill will discuss.

18 There is also a very big piece of our  
19 program that's examinations. The division  
20 conducts onsite examinations of DCOs to ensure  
21 compliance with DCO core principals and relevant  
22 regulations with a particular emphasis on risk

1 management. A lot of our focus is on the  
2 systemically important DCOs for obvious reasons  
3 where these are examinations that are occurring  
4 every year at the systemically important DCOs.

5 From a prelaunch perspective as I  
6 discussed on the first panel, not every new  
7 product requires a rule filing or formal  
8 notification to the Commission on the clearing  
9 side. But even when a rule filing is not required  
10 there are informal discussions between DCR and DCO  
11 when a DCO plans to clear a novel or complex new  
12 product. A focus of these prelaunch discussions  
13 usually is margin requirements for the new  
14 product.

15 DCR staff may and often does request  
16 data and background information to assess the use  
17 of the model and the proposed margin requirement  
18 that are being protected by that model. Depending  
19 on the circumstances those discussions can be  
20 quite extensive. I think Dale referenced the  
21 discussions in his remarks on panel one quite  
22 extensive with OCC on bitcoin futures as well with



1 staff at CME.

2           There are a number of margin related  
3 requirements for DCOs under our regulations. A  
4 DCO's margin model and each parameter of that  
5 model must be risk based and reviewed regularly by  
6 the DCO. Initial margin requirements must be  
7 commensurate with the risks of each product and  
8 portfolio. A DCO must use a minimum liquidation  
9 time or margin period of risk of one day for  
10 futures, options and swaps on certain commodities  
11 and five days for other types of swaps. And then  
12 the Commission has the authority by order to  
13 establish shorter or longer liquidation periods  
14 for particular products or portfolios. And then  
15 initial margin requirements must meet a 99 percent  
16 confidence level. This translates to an expected  
17 value of no more than two or three margin breaches  
18 in any given year. And I can tell you from the  
19 work we did with both OCC and CME where they ended  
20 up with their margin requirements is well above  
21 that 99 percent confidence level, the minimum  
22 required by our regulations. In fact it

1 approaches 100 percent confidence level based on  
2 available data that we have going back five years  
3 in Bloomberg.

4           These requirements are a particular  
5 focus in a prelaunch review of novel or complex  
6 products and then there are some additional  
7 ongoing requirements related to margin including  
8 that the DCO must review and validate their margin  
9 models regularly. They must review the adequacy  
10 of their initial margin requirements on a daily  
11 basis and conduct daily and monthly back tests to  
12 assess the adequacy of initial margin requirements  
13 and again as Bill will discuss that's something  
14 that we do as well as a check on the DCO's  
15 activities and we do those quite regularly as  
16 well.

17           So with that I think I will turn it over  
18 to Bill to talk a bit more about this very  
19 important ongoing risk surveillance that we do.

20           MR. HEITNER: Thank you, Brian. I'm  
21 Bill Heitner. I'm going to talk a little bit  
22 today about the division's risk surveillance

1 activities and give some examples as to how they  
2 relate to the new bitcoin futures contracts. The  
3 division performs a number of surveillance and  
4 oversight activities to ensure that clearing of  
5 related risks are being properly managed. The  
6 division performs daily risk surveillance in which  
7 we attempt to identify and quantify risks in all  
8 cleared products. These products include futures  
9 and options, credit default swaps, interest rate  
10 swaps and foreign exchange swaps.

11 The division performs clearing member  
12 compliance reviews which involve onsite reviews of  
13 clearing members to ensure that they are in  
14 compliance with risk management requirements under  
15 regulations 1.73 and 23.609. The division  
16 performs margin model reviews of new margin models  
17 and changes to existing margin models to ensure  
18 compliance with Commission regulations. And the  
19 division has a margin model back testing program.

20 Commission regulation 39.13 requires  
21 DCO's to conduct margin back testing to assess  
22 adequacy of initial margin. The division also has

1 a back testing program. The division's back  
2 testing program has two objectives. To test the  
3 adequacy of initial margin for bench mark products  
4 at DCO's and monitor the performance of DCO risk  
5 management policies with respect to setting  
6 initial margins.

7 Now I would like to give you some  
8 examples of some of our efforts as they relate to  
9 the new bitcoin products. Since the initial  
10 launch of bitcoin futures products, we have been  
11 receiving data from the DCO's. This data includes  
12 positions, margin and cash flow. We use this data  
13 to create position reports for both large traders  
14 and clearing members. Our large trader reports  
15 calculate net positions, total longs and total  
16 shorts across both DCO's. We also calculate  
17 positions for clearing members and we stress test  
18 those positions.

19 Our stress tests are at price changes of  
20 100 percent, 100 percent price moves both up and  
21 down. And then we calculate those losses and we  
22 compare them against margin on deposit for the

1 clearing member's financial resources and the  
2 financial resources of the DCO. We also calculate  
3 and review margin erosion. That's the change in  
4 price compared to the margin rate. We look for  
5 margin breaches and we look for consistently high  
6 price fluctuations relative to margin.

7 We prepare a weekly report which is  
8 distributed to the chairman, the commissioners and  
9 other divisions summarizing our findings. In the  
10 event that we identify any concerns related to  
11 risk, related to a trader or a clearing firm, we  
12 would contact the clearing firm of the DCO to  
13 discuss corrective action. Similarly if we  
14 identify any risk related to margin we would  
15 contact the DCO to discuss potential changes in  
16 the margin model. To date we have not determined  
17 that we needed to take any corrective actions.

18 I would like to note as well that based  
19 on the open interest in bitcoin futures at CME and  
20 OCC that risk in bitcoin futures is relatively  
21 small related to the financial resources of the  
22 clearing firms and the DCO's. With that I'll turn

1 it over to Matt Kulkin.

2 MR. KULKIN: Good morning, everybody.  
3 Thank you for having me. I'm Matt Kulkin, I'm the  
4 director of the Division of Swap Dealer and  
5 Intermediary Oversight. DSIO. I would like to  
6 just give a brief overview of our division's  
7 regulatory oversight function as it relates to the  
8 risks posted to intermediaries and market  
9 participants associated with listing new products  
10 with novel or unique profiles. So our role is  
11 primarily focused on the approximately 60 active  
12 FCMs, the SROs that monitor clearing members of  
13 CME and the NFA and the thousands of registered  
14 commodity trading advisors, commodity pool  
15 operators and introducing brokers.

16 I would like to just touch on two  
17 points. So the first is the role that we play  
18 through regulation and examination and this is for  
19 all contracts and it's designed to identify and  
20 mitigate possible risks to the market and to  
21 ensure the effective operation of market  
22 intermediaries including the safe holding of

1 customer funds.

2 Second and I'll touch on this in a  
3 moment, as it relates specifically to novel  
4 products, we have worked closely with colleagues  
5 in DCR, DMO and enforcement as well as at the NFA.

6 So on the first point, we implement the  
7 Commission's regulations as they relate to  
8 intermediaries. So with respect to FCMs our rules  
9 require and our staff examiners review for  
10 compliance with a series of obligations designed  
11 to maintain the stability of our markets. So that  
12 includes daily segregation statements  
13 demonstrating that the FCMs hold customer funds in  
14 accordance with our rules, monthly financial  
15 statements demonstrating that FCMs are compliant  
16 with minimum capital requirements and customer  
17 segregation requirements. Bimonthly segregation  
18 information reports showing where and how the FCMs  
19 actually hold and invest customer funds and of  
20 course collection of margin.

21 DSIO's examination branch has staff in  
22 New York, Chicago and Kansas City and in addition

1 to just being in regular close contact with  
2 registrants, they regularly review reports from  
3 the FCMS and investigate the required notices that  
4 are filed by FCMS related to low capital levels or  
5 segregated funds among other issues. The staff  
6 who work closely with the DSROs also conduct  
7 examinations to verify that the customer funds are  
8 in fact where the registrants say they are being  
9 held.

10 So second I wanted to talk about our  
11 coordination with NFA and CME to make sure that  
12 its members are complying with the CEA, the  
13 Commission's regulations and the NFA and CME  
14 rules. So in recent months with the introduction  
15 of these new virtual currency futures contracts,  
16 you've probably seen the NFA has issued investor  
17 advisory notices. They've imposed new reporting  
18 obligations on CPOs, CTAs, IBs and certain FCMS.  
19 The NFA has also actively monitored its members to  
20 better understand who is active in these new  
21 contracts and they have taken steps to minimize  
22 risk and ensure that market participants



1 understand the risks inherent with these new  
2 contracts.

3           And finally I will just point out that  
4 DSIO has coordinated closely with DMO, DCR and  
5 enforcement to help provide information about our  
6 particular area of jurisdiction. We have tried to  
7 help kind of fill in the gaps as it relates to the  
8 data that we receive and to provide color to  
9 Commission staff on what our registrants are  
10 reporting to us with these new contracts in the  
11 early days.

12           So we have been able to add information  
13 either from our own or information we are getting  
14 from the NFA that can be overlaid on top of the  
15 DMO's exchange information, DCR's clearing house  
16 information to help give a little bit more  
17 perspective of the clearing member and also to  
18 better appreciate the dynamics of what is going on  
19 in the market based on the number of CPOs, CTAs or  
20 IBs who are engaged in facilitating trading. And  
21 with that I would be happy to answer questions  
22 after Jamie speaks.

1                   MR. MCDONALD: Thank you. Good morning,  
2                   Mr. Chairman, Commissioner Behnam, Commissioner  
3                   Quintenz, Chairwoman Lewis and members of the  
4                   Advisory Committee. Thank you for the opportunity  
5                   to participate today. As Director of Enforcement,  
6                   I oversee both the enforcement and surveillance  
7                   functions at the Commission. I will begin today  
8                   by offering a bit of the overview of the current  
9                   structure of the Division of Enforcement because  
10                  it has changed over the last year. Then I will  
11                  discuss how we approach surveillance in general  
12                  and what's unique about our surveillance of new  
13                  products.

14                  First I want to talk just a little bit  
15                  about the structure of enforcement. Last year, the  
16                  CFTC moved the Market Surveillance Unit from the  
17                  Division of Market Oversight into the Division of  
18                  Enforcement. The CFTC made this move in  
19                  recognition of the significant overlap between the  
20                  enforcement and surveillance functions. Here's  
21                  what I mean when I say significant overlap. The  
22                  CFTC's mission is to foster open, transparent,

1 competitive and financially sound markets. In  
2 furtherance of this mission, both enforcement and  
3 surveillance seek to preserve market integrity and  
4 protect market participants.

5 Both enforcement and surveillance do this  
6 by seeking to hold wrongdoers accountable and deter  
7 future misconduct. They do it together. To hold  
8 wrongdoers accountable we have to identify them, a  
9 surveillance function and we have to successfully  
10 bring enforcement actions, an enforcement function.  
11 To adequately deter misconduct, market participants  
12 tempted by misconduct have to know that they are  
13 going to be identified. That's surveillance. And  
14 they have to know that they are going to be  
15 prosecuted after they're identified. That's  
16 enforcement. It makes good sense to me then that  
17 enforcement and surveillance that both of those  
18 functions will now be housed under the same roof  
19 within the Division of Enforcement. We've already  
20 enjoyed some of the benefits of this realignment  
21 and I expect that we will see many more going  
22 forward.

1                   Now more specifically, the work of  
2                   surveillance. The primary work of market  
3                   surveillance is the same whether we are talking  
4                   about a new product or an old one. That work  
5                   focuses on conducting market surveillance to  
6                   identify fraud, manipulation and abusive or  
7                   disruptive trade practices in our markets. The  
8                   market surveillance unit does this in a number of  
9                   ways.

10                   First, and most importantly in my view is  
11                   human capital. Our market surveillance unit has  
12                   developed particular expertise across a range of  
13                   markets and products. As new products are listed,  
14                   surveillance staff develops additional expertise in  
15                   those areas. Given the nature of surveillance  
16                   work, the skill set of our surveillance staff is  
17                   broad so the staff can quickly develop expertise in  
18                   new products. When it comes to new products,  
19                   depending on the type, we might devote specific  
20                   surveillance staff to monitoring and surveilling  
21                   trading in those products. So first is human  
22                   capital.

1           Second the market surveillance unit uses  
2 data analysis to conduct surveillance and identify  
3 misconduct in our markets. This in particular has  
4 been a focus for us in the past year. Just a few  
5 days ago, we filed a series of manipulation and  
6 spoofing cases in conjunction with the Department  
7 of Justice and the Federal Bureau of Investigation.  
8 We identified some of that alleged misconduct using  
9 sophisticated data analysis, using new tools  
10 through which we could identify trading patterns  
11 that reveal unlawful conduct. I expect going  
12 forward we are going to use this type of data  
13 analysis across a range of trading activity to  
14 detect various forms of misconduct.

15           Some of this data work can include cross  
16 market analysis and analysis of the underlying cash  
17 market to identify efforts to manipulate the  
18 derivative contract through trading activity in  
19 another market. We can access that data in a  
20 number of ways including pursuant to information  
21 sharing agreements the exchange has in place with  
22 participants in the other markets. The way we

1 perform this data analysis remains largely  
2 consistent whether we are talking about old  
3 products or new. The parameters and the specifics  
4 of what we are looking for might be different  
5 depending on the product, depending on the market.  
6 But the basic tools, the basic data analytical  
7 tools are largely the same.

8 Third, our market surveillance unit  
9 conducts surveillance by gathering intelligence  
10 from the exchanges, from market participants and  
11 from a number of other sources. With any trading  
12 product our staff will be in communication with the  
13 exchange but the communication is much closer and  
14 much more frequent with respect to certain types of  
15 new products. That's particularly with respect to  
16 new products that are likely to have significant  
17 trading or that might have initial volatility.

18 When these new products are listed we  
19 will have an open line of communication with the  
20 exchange that's listing that product and that line  
21 of communication is open prelaunch, during initial  
22 trading and during the settlement period. Our

1 prelaunch discussions generally would center around  
2 the status and onboarding process for potential  
3 market participants, the clearing capabilities and  
4 processes, rules in place regarding trading halts  
5 and the process for settlement including any  
6 contingencies.

7           Post launch, these communications would  
8 concern trading activity including halts, open  
9 interest, market positions and identification of  
10 large traders and any hedge exemptions. We would  
11 promptly notify the exchange if we identify any  
12 surveillance concerns and we would expect to be  
13 notified if the exchange identifies any  
14 surveillance concerns.

15           Surveillance in the exchange will also  
16 share information around the settlement process.  
17 We closely market -- we closely monitor the market  
18 during the settlement process. Before, during and  
19 after that settlement we are going to be in close  
20 contact with the exchange to ensure an ordinary --  
21 an orderly close. We will be monitoring among  
22 other things the positions going into the

1 settlement, how large traders are reducing their  
2 positions, whether through rolling over or  
3 offsetting and whether there is convergence between  
4 the derivative and cash price at settlement.

5 Finally Amir, on the first panel, talked  
6 about the core principles. We in surveillance have  
7 the ability to require exchanges to demonstrate  
8 compliance with their core principle obligations  
9 and if necessary that's another step that we can  
10 take to ensure that everything is running smoothly  
11 in the market from a surveillance perspective.  
12 Thank you and I'm happy to answer any questions.

13 MR. ARCHITZEL: Thank you all. I think  
14 the first question that perhaps this raises is  
15 what is the relative merit of prelaunch versus  
16 post launch commission review in oversight  
17 processes? Is the balance correct or should it be  
18 altered?

19 MR. BUSSEY: The -- I guess I will push  
20 back a bit at the underlying premise of the  
21 question. I mean, I view it much in terms of I  
22 really view it more seamlessly than that. Our



1 work, you know, we did a lot of prelaunch work in  
2 the weeks leading up to, more than a month leading  
3 up to the self-certification. But our work was  
4 not done at that point as Bill pointed out. We  
5 continue to do significant amount of work  
6 monitoring of the products so I see it more of at  
7 least from an internal CFTC perspective I see it  
8 as more of a, kind of more of a piece as opposed  
9 to distinct processes. Obviously there is a time  
10 when the launch occurs but again the work is not  
11 done after the prelaunch activities are concluded.

12 We continue to very much monitor  
13 significant introductions of products and  
14 obviously as a product becomes much more  
15 important, some of the benchmark contracts spend a  
16 lot of time on those products. Essentially a  
17 risk, you know, by levels of risk that are  
18 presented to the clearing house and the clearing  
19 system.

20 MR. KULKIN: And I would just add to  
21 Brian, you know, for as much as we have talked  
22 about our individual divisions and the components

1 of the regulations that each of us work with.  
2 It's really, this has been a commission at the  
3 staff level. This has been a commission effort  
4 across the board and, you know, it really does  
5 take the different perspectives and the different  
6 regulatory components that each of us bring to  
7 work on something like this whether it's before,  
8 during or after and so I know that each of us have  
9 presented today sort of how we look at things but  
10 it really, it really isn't done in a vacuum or  
11 none of this has been in a silod way and I think  
12 that is really important to remember that every  
13 time one of us has an observation or an obligation  
14 we are sharing that information with each other so  
15 that we can kind of get the whole picture.

16 MR. MCDONALD: Paul, the only thing I  
17 would add to that is though for conversation and  
18 analytically we can separate it prelaunch, during  
19 the launch, post launch. I think in practice we  
20 view it as a continuing process. From a  
21 surveillance standpoint the launch is incredibly  
22 important. It's something that we are going to be

1 monitoring, that we are monitoring very closely.  
2 We are in conversations with the exchanges, we are  
3 monitoring the market participants, we are  
4 monitoring the launch and there is a lot of work  
5 from the surveillance standpoint that goes into  
6 preparation for the launch.

7           So we can talk pre-launch, during the  
8 launch and post launch but I understand why we  
9 want to have that conversation for purposes -- why  
10 we want to have the distinctions for purposes of  
11 the conversation but I think what we would say is  
12 that from the staff standpoint and from our  
13 perspective it really is one thing leading to the  
14 next making sure that all of the work prelaunch is  
15 incorporated into the launch which then is  
16 incorporated into the analysis of the actual  
17 trading which then gets brought into the  
18 settlement which then gets moved over to the next  
19 contract period.

20           MR. HEITNER: I would like to echo what  
21 Matt said. Risk analysis and financial analysis  
22 are very intertwined and so our Chicago risk staff

1 works very closely with the DSIO staff and even  
2 just recently we had a joint review of a clearing  
3 firm and we do that all the time, I mean, that's a  
4 regular, regular event so we work very closely  
5 together.

6 MS. LEWIS: The chair recognizes Kristen  
7 Walters.

8 MS. WALTERS: Thank you. So I guess  
9 just to re-ask the question I asked previously  
10 because I noted in your comments that a couple of  
11 you noted again that some of your concerns about  
12 the product are based on the relatively small size  
13 that's currently traded. And that's true again so  
14 500 billion to 800 billion in market cap for  
15 crypto currencies versus an 80 trillion dollar,  
16 you know, global money stock is very small. So I  
17 understand that but I know from an enforcement  
18 perspective, you also and market surveillance, you  
19 also said that your risk process does involve  
20 evaluating the underlying risk of the spot markets  
21 themselves.

22 So I guess I wanted to ask again when

1 would you -- and recognizing that the statues are  
2 focused on the futures markets themselves not the  
3 underlying when do you start considering the spot  
4 market when you do your surveillance? And just  
5 thinking about the fact that and I know there were  
6 comments that this instrument is no different than  
7 others but, you know, global central banks, the  
8 SEC recently have all taken similar positions  
9 relative to crypto assets so they are highly  
10 speculative and they're extremely vulnerable to  
11 fraud and manipulation and there have been  
12 explicit warnings to investors about the dangers  
13 in risk in investing in these assets.

14           And, you know, currently we don't man  
15 from a BlackRock perspective, crypto currencies  
16 aren't part of any index that we manage assets  
17 against nor are they part of any of our products.  
18 And a lot of that is due to the current regulation  
19 but we do recognize that this area is rapidly  
20 evolving. Kind of with that backdrop just I again  
21 wanted to ask like when does this spot market and  
22 the attributes of the underlying assets on which

1       these futures are traded, when does it become  
2       relevant and when it is something that you  
3       consider when you think about the product itself  
4       and surveillance?

5                   MR. MCDONALD:  So I'll speak first from  
6       an enforcement and surveillance standpoint and  
7       then I will tell my colleagues comment from their  
8       perspective to the extent that they have got  
9       comments.

10                   To begin with, our jurisdiction so the  
11       enforcement jurisdiction includes jurisdiction for  
12       fraud and manipulation of the underlying cash  
13       market.  And we have brought cases going back to  
14       2015.  We have brought cases in the virtual  
15       currency context and in the fall of 2017 and then  
16       again a couple weeks ago we brought additional  
17       fraud cases in the spot bitcoin market and the  
18       spot virtual currency market.  So from an  
19       enforcement standpoint that's -- the fraud and  
20       manipulation jurisdiction is it falls within the  
21       Division of Enforcement.  It's something that we  
22       are looking at from an enforcement standpoint.

1                   From a surveillance standpoint, where  
2                   you have got a derivatives contract that is  
3                   settling to the under, to something in the  
4                   underlying spot market, we are going to be looking  
5                   at the underlying spot market. We are going to be  
6                   looking at it not to ensure a -- not to do a  
7                   comprehensive surveillance and review of the  
8                   underlying spot market but we are going to be  
9                   looking at it because it's the -- because it is  
10                  part of the settlement process. It's informing  
11                  the price discovery process and the futures  
12                  contract.

13                  And so what that means is from  
14                  surveillance, yes of course we start with the  
15                  futures contract and we start with evaluation the  
16                  trading on the futures exchange and the settlement  
17                  process but because that settlement process ties  
18                  in to the underlying that's something that we  
19                  would be looking at.

20                  MS. WALTERS: Yes, so I understand the  
21                  fraud and manipulation component of surveillance  
22                  and enforcement. I guess the other aspect is the

1       sheer volatility of the underlying asset that's  
2       nearly impossible to value. And also from a fraud  
3       and manipulation perspective, in the contents --  
4       in the context of cyber and this particular asset  
5       like how do you even identify fraud and  
6       manipulation just given the sheer opaqueness and  
7       complexity of the algorithms, mining process  
8       behind this asset?

9                 MR. MCDONALD: So I don't want to talk  
10       about any of our particular surveillance tools or  
11       enforcement tools but what I can say is that to be  
12       sure conducting surveillance of any new product in  
13       any new market presents challenges as we make sure  
14       that we are equipped and that we have, that we we  
15       have all the capabilities to conduct the adequate  
16       surveillance.

17                The features that you are talking about  
18       in the virtual currency market are things that we  
19       are thinking about, they are things that we are  
20       looking at. I just want to be clear though that  
21       we are looking at it, we are starting from the  
22       derivatives contract, we are starting from the



1 futures listing and so I think a lot of what  
2 you've just described I think you started your  
3 question with a discussion about virtual  
4 currencies. I think from my perspective, there  
5 are a number of follow on questions that we would  
6 need to ask before I can provide any specific  
7 details about exactly what we are doing from  
8 surveillance. But the characteristics of a number  
9 of different virtual currencies are different.  
10 Some of them are designed to be anonymous, not to  
11 be able to identify the underlying owner not to  
12 mention the trader who is trading on a particular  
13 exchange.

14           And from a surveillance standpoint I  
15 might view those types of virtual currencies  
16 differently from how I view virtual currencies  
17 that had -- where we were able to have more  
18 insight into the owner of the underlying commodity  
19 or asset and then when you talk about trading  
20 activity, a question is going to be well, can we  
21 identify the traders who are trading first on the  
22 futures market and then when we are looking at the

1 futures market, are there particular things in the  
2 cash market and the cash particularly in the  
3 settlement process that we need to look at to  
4 ensure that the futures contract isn't -- the  
5 price process and the futures contract isn't the  
6 product of broader manipulation.

7 MS. WALTERS: Yes.

8 MS. LEWIS: Kristen?

9 MS. WALTERS: Yes.

10 MS. LEWIS: I'm sorry, allow me an  
11 opportunity to get in some of the other members.

12 MS. WALTERS: My apologies.

13 MS. LEWIS: The Chair recognizes Rana  
14 Yared.

15 MS. YARED: Thank you. So my comments  
16 are going to center around the question of what  
17 work should be done and needs to be done by the  
18 applicant prior to submission in order to ensure  
19 that the market is ready to receive the positions  
20 or the risk once the new contract is launched. So  
21 as an institution we take no issue to the  
22 (inaudible) self-certification. Quite the

1 opposite. We think that it has actually  
2 promulgated innovation that otherwise may not have  
3 happened. However, as a major clearing member and  
4 a mutualizer of the DCO's we believe that it is  
5 critical for the FCMS to be in a position to  
6 enthusiastically receive the contracts and  
7 positions from our clients and to risk manage them  
8 appropriately.

9           Just to give folks context, it is common  
10 in the FCM world for the give up agreement, the  
11 contracts that govern the way in which our clients  
12 give us their contracts to not specify product in  
13 which we are accepting. And so the launch of the  
14 products by both the CBOE and the CME left us in a  
15 very interesting position of having to receive  
16 contracts from clients that we ourselves have not  
17 made a decision as to how we would model, whether  
18 we would even trade them ourselves, what would be  
19 the risk limits that we would place, et cetera.

20           And it brings to mind for me the comment  
21 that the Chairman had started by making which is  
22 what kind of heightened review can we place such

1       that when the application is made to the CFTC it  
2       suggests that there is already a series of checks  
3       that have taken place. And so from the GS point  
4       of view, we would want some sort of formal  
5       demonstration or attestation or something from the  
6       major DCO's when they are launching something  
7       truly new and novel that says that a significant  
8       proportion of the FCMS are enthusiastically ready  
9       to take on this contract but two, believe that the  
10      risk management is appropriate and meets the same  
11      standards that they have set in their own  
12      institutions and that they are open for business.  
13      Otherwise, you're launching a product that clients  
14      want to trade but the FCMS are not ready to take  
15      it on for whatever reason.

16                   MR. BUSSEY: Harkening back to the  
17      Chairman's comments both in Naples and then this  
18      morning that he reiterated, I think one of the  
19      focuses that he has asked us to undertake in DCR  
20      going forward is to look very closely at  
21      governance around, DCO governance around the  
22      launch of new products and we are undertaking that

1 with enthusiasm and hope to come back to Chairman  
2 and the Commission with our thoughts on that and I  
3 think that goes towards the kind of changes that  
4 you're suggesting. I would be interested myself  
5 in hearing both OCC and CME, CME's thoughts on  
6 that since it really I think is directed first and  
7 foremost to the two clearing houses.

8 MS. LEWIS: And that will be on the  
9 third panel.

10 MR. BUSSEY: Okay.

11 MS. LEWIS: The Chair recognizes Jerry  
12 Jeske.

13 MR. JESKE: I'm Jerry Jeske for  
14 Commodities Market Counsel. So I heard what  
15 Kristen had to say about the big money managers  
16 and Rana had to say about the large banks. We are  
17 a group that participates in the and I'll use  
18 Chairman Giancarlo's comment, stakeholder process.  
19 And I think it's a good thing to focus on and  
20 before I get in to some of my comments I would  
21 like to commend staff, both this staff and the  
22 prior group for all the hard work that they have

1 done. I know we are focusing on crypto currency  
2 but what I would like to say is not to lose sight  
3 of I think there was a chart up here a little  
4 earlier about the thousand different contracts  
5 that had been listed over time and the amount of  
6 due diligence that's done. Not just from a, you  
7 know, CFTC staff perspective but from the  
8 exchanges perspective.

9           So to the concept of what has been done  
10 by way of due diligence, the FCM community, the  
11 end user community, the groups that use these  
12 products, not just crypto currency but all of the  
13 other successful products that have been launched  
14 as a risk management tool is essential. It's  
15 essential for good operating markets. And that's  
16 what I think the staff deserves to be commended  
17 on, the Commission deserves to be commended on and  
18 the DCO's.

19           We are focusing on one particular asset  
20 I guess you can call it an asset, I don't know. I  
21 can be corrected on that one for sure. We are  
22 talking about a thousand contracts right now on

1 open interest. Compared to for example the Loop  
2 Storage contract for oil which is a relatively new  
3 contract, it has 20,000 open interest. Very  
4 successful risk management tool. I think we need  
5 to be careful about what we ask for by way of the  
6 self-certification process being criticized or  
7 otherwise made more formal. Because again the end  
8 user process, the ability to interact with the  
9 exchanges in a commercial management is essential  
10 and that is done on many, many occasions and is a  
11 never ending process unfortunately. So certainly  
12 I appreciate the position of the FCMs and their  
13 clients. We happen to be clients with a few FCMs  
14 and there should be interaction there certainly.  
15 But those organizations need to take that upon  
16 themselves to interact with their constituents and  
17 certainly the exchanges do that in many, many of  
18 these products that have been successfully  
19 launched.

20 And then looking at comparatively other  
21 asset classes such as electricity and power and  
22 the stakeholder process associated with RTOs and

1 ISOs is nowhere close to what the Commission  
2 enjoys and what the commodities market enjoys.  
3 Likewise in Europe ICE Futures EU just launched 37  
4 contracts in mid-January. The process associated  
5 with launching contracts is a never ending one.  
6 But everybody wants the next Treasury bond  
7 contract of course. So there is natural  
8 competition which is a good thing and I would say  
9 on behalf of the CMC that we are ones that enjoy  
10 seeing competition not just from an FCM  
11 perspective but obviously from exchanges, other  
12 exchanges being introducing contracts, forced  
13 innovation and I think that's just a very positive  
14 thing so thank you all for your time and effort in  
15 this process.

16 MS. LEWIS: The Chair recognizes  
17 Kathleen Cronin.

18 MS. CRONIN: You know, one of the points  
19 that has been made several times concerns about  
20 the volatility of the underlying market. We list  
21 a lot of contracts on markets that have underlying  
22 volatility and in fact we consider that to be



1 important in terms of when we think about listing  
2 a contract, our purpose is to allow people to  
3 manage their risk and to the extent that an  
4 underlying market has some degree of volatility,  
5 you know, a futures contract has significant value  
6 in allowing people to manage that risk. And we  
7 have in place in terms of ensuring the integrity  
8 of the futures market, first we go through a  
9 robust process when we decide to list a new  
10 contract to ensure that it meets all the criteria  
11 necessary so we are in compliance with our core  
12 principles and some of that includes, you know,  
13 the liquidity and the underlying market, the  
14 ability for price discovery in the underlying  
15 market and most importantly, how we construct our  
16 index and whether that is a fair representation of  
17 what is going on in the market.

18 So it can take into account anomalies in  
19 terms of pricing and given that we have four  
20 exchanges that we get data from we feel like it  
21 presents a broad cross section of the underlying  
22 market. Then once we have looked at that and the

1 construction of the index and are happy with that,  
2 we go through our usual process of setting the  
3 margin which again is subject to adjustment over  
4 time and that's only at the beginning of our risk  
5 management controls because we have a number of  
6 other controls in place which include trading  
7 halts and circuit breakers which are mechanisms in  
8 our market to help minimize volatility and we have  
9 other protections as well in terms of credit  
10 controls and a number of different mechanisms to  
11 manage the risk.

12           So we are quite comfortable that the  
13 risk profile of this contract is no different than  
14 the risk profile of many other contracts that we  
15 offer and that we are able to effectively margin  
16 it and account for that potential risk.

17           MS. LEWIS: The Chair recognizes  
18 Biswarup Chatterjee.

19           MR. CHATTERJEE: First of all I would  
20 like to thank DCR. I think, you know, it was very  
21 commendable and I think very, you know, very happy  
22 to hear that, you know, the amount of due

1 diligence that went behind into applying the  
2 historic data and looking at the adequacy. Not  
3 only trying to achieve 99 but like you said almost  
4 100 percent, you know, coverage. Going back to I  
5 think a couple of MRAC meetings where this  
6 committee focused a lot on the safety and  
7 soundness beyond -- and the resources beyond the  
8 initial margin which is, you know, the rest of the  
9 waterfall, skin in the game, you know, funded and  
10 unfunded contributions. Recognizing how complex  
11 the clearing houses and the clearing landscape has  
12 become, you know, multiple products, Futures, OTC  
13 swaps, some exchange rated, some OTC traded.  
14 Where do you think and, you know, this is for the  
15 panel as well as for the rest of the committee.

16           Where does in the new product or more  
17 importantly in the ongoing monitoring does  
18 consideration come into the rest of the resources  
19 and the sensitivity that a new product may expose  
20 risks to the subsequent areas, the waterfall, you  
21 know. Obviously IM is the first line of defense  
22 and we get that right, we are never testing the

1 rest of the waterfall but at what point should,  
2 you know, the consideration be given to ensure  
3 that the new product either launch or ongoing  
4 monitoring doesn't open up, you know, that risk.  
5 Or to maybe what my colleague from Goldman Sachs  
6 mentioned, does that should be that part of the  
7 initial disclosure that the clearing houses have  
8 to give to the market place that they have looked  
9 at these considerations.

10 MR. BUSSEY: I think a part of that is  
11 the stress testing that we do and that we expect  
12 the DCO's to do and as Bill I think mentioned in  
13 his opening remarks, we are using very extreme  
14 shocks in this circumstances. We are looking at  
15 100 percent moves both up and down so the  
16 possibility that the bitcoin goes to zero in a day  
17 in doing our analysis so that, so I think that is  
18 a first line of dealing with that is looking at  
19 very extreme shocks when we are doing stress  
20 testing and again we would expect the DCO's to be  
21 doing similar types of stress testing and that  
22 will be a focus of the examination that we were --

1 examination work that we do going forward. I  
2 don't know if you have something to add, Bill?

3 MR. HEITNER: No, right. We looked at  
4 the same thing pre-launch as well, what effect the  
5 new product would have. We created some  
6 hypothetical portfolios, we've stress tested those  
7 as well and we wanted to see potentially what  
8 effect these new products would have on the  
9 waterfall and we do that same type of analysis so  
10 both pre and post launch we use stress testing to  
11 see what the effect could be of these products and  
12 to date we haven't had any concerns. But as open  
13 interest grows, we will continue doing this  
14 analysis.

15 MR. ARCHITZEL: I think as a follow up  
16 to that question, one question is whether or not  
17 the exchanges and clearing houses have incentives  
18 that have changed over time and if so how have  
19 those changed incentives affected the Commission's  
20 work and does the Commission, has the Commission  
21 taken that into account in the processes that it  
22 uses either pre or post launch for new products?

1                   MR. BUSSEY: Yes, sure. You know, I  
2 think so my work both at the SEC running the  
3 clearing program and over here has been in this  
4 new era that we are in and so from my perspective,  
5 I mean, we take the risks that are taken on by  
6 DCO's very seriously both pre-launch and post  
7 launch and we will continue to do so. I just  
8 don't have the historical perspective that goes  
9 back to the mutualized days of CME back many years  
10 before I was a, many years before I was in the  
11 regulation business. But again I think the  
12 message both on the first panel and the second  
13 panel with Bill and me has been that we take risk  
14 very seriously. The DCO's engage in dialogue both  
15 before launch and after launch. Its ongoing and  
16 very serious work that is done by the staff and  
17 DCR.

18                   MS. LEWIS: The Chair recognizes Marcus  
19 Stanley.

20                   MR. STANLEY: Yes, this is just a  
21 question that goes to some of the general issues  
22 about the surveillance of the margin models and

1 stress testing and also some of the things I think  
2 Kathleen said about CME's work in terms of setting  
3 margin. The press has reported that CME initially  
4 proposed a margin of 27 percent for bitcoin  
5 derivatives. Then it was increased to 35 percent  
6 following discussion with the CFTC and then rather  
7 rapidly after introduction, it increased to 47  
8 percent. And I was -- is that driven just kind of  
9 by, I mean, was that expected in terms of the,  
10 this kind of very sharp change in margin and could  
11 those kind of sharp changes create some general  
12 market risk if this was a product that frankly was  
13 larger? And does that change say anything about  
14 the margin models themselves which you said didn't  
15 have to be changed or altered for this product or  
16 was it just a level of volatility in the  
17 underlying that was unexpected?

18 MR. BUSSEY: So when they came in first  
19 to talk to us they always speak in ranges when  
20 they are starting out the process so they don't  
21 give a definitive number and they actually came in  
22 and this is CME specifically. They came in with a

1 range that on the low end was 27 and the high end  
2 was in the mid-30s. We engaged in discussion with  
3 them, we did back testing, we -- back testing at  
4 the 27 percent number and that met our standards  
5 of 99 percent confidence level. We did have  
6 discussions, discussions at various levels in the  
7 Commission with CME about that and as well there  
8 was obviously a lot of market discussion about the  
9 product.

10           And as well if you will recall it seems  
11 already in the distant past in the weeks and  
12 months leading up to the launch for the product  
13 particularly those weeks in October and November  
14 there was significant volatility on the upside.  
15 That seems to be well in the past at least as of  
16 2018. And I think those all contributed to a  
17 decision for CME first to come in at the high end  
18 of the range that they were proposing, the 35  
19 percent. And then that was the number that they  
20 were telling us at the time of the certification.  
21 And then I think that high end volatility came in,  
22 it continued up to the actual launch and for their



1 own business reasons they decided to move it up to  
2 the, into the 40's from 35 percent.

3 But again, these numbers even if they  
4 had stayed at the 27 percent level it would have  
5 been within the confidence requirements of our  
6 regulations so this is well beyond, well beyond  
7 what the requirements are. And you see that in  
8 the margin erosion work that we do on a daily  
9 basis. Looking at how much the margin erodes  
10 based on market moves since launch and, you know,  
11 in comparison with a lot of the major products  
12 that are traded on the major futures exchanges.  
13 You don't -- the margin erosion is not at the high  
14 end of what we see for some products. Bill, do  
15 you have?

16 MS. LEWIS: The Chair recognizes -- I'm  
17 sorry, Bill?

18 MR. HEITNER: I was just going to say  
19 that this thing that shows that the increases in  
20 the margin requirement just show their  
21 responsiveness, quick responsiveness to changes in  
22 volatility. I think it's a, it just shows that

1           they are very responsive.

2                       MS. LEWIS: The Chair recognizes Dale  
3           Michaels.

4                       MR. MICHAELS: And maybe give a little  
5           bit more insight from a clearing house perspective  
6           about the different margin levels. We look at it  
7           from a two year history at OCC. So when we first  
8           started looking at bitcoin in the June timeframe  
9           when we had the price history of two years, we  
10          looked at the margins and they were in the mid 30  
11          percent range based on our model and I will go  
12          into that more into the third panel. But that's a  
13          point in time. Every day we add a day, we drop a  
14          day, we add a day, we drop a day. The volatility  
15          as volatility is increasing, the margins will  
16          increase with it or the volatility is decreasing,  
17          the margins will generally decrease. So anything  
18          we would have seen beforehand would have just been  
19          a snapshot in time.

20                      So as the launch got closer and we went  
21          to a December launch, at that point in time with a  
22          little bit more volatility in the Oct and Nov

1       timeframes you saw that the margins were upwards  
2       of 40 percent. That's just reflective of the  
3       margin models doing what they do and taking in the  
4       more current history, dropping the older history  
5       to be reflective of the current market conditions.

6                 The other point that I wanted to make is  
7       on stress testing. This is also something that  
8       was brought in to the governance, something that  
9       was reviewed by the CFTC as well. So when we are  
10      having the discussions with our risk committees,  
11      we are having discussions with the clearing  
12      members which we meet with on a periodic basis in  
13      a formal process at the OCC. We discuss what the  
14      margins are and what the stress testing is going  
15      to be. We provide the data of what we are going  
16      to use for our clearing fund, whether the clearing  
17      fund needs to have any other changes, the stress  
18      tests we are going to be using and provide that  
19      information in discussions with the CFTC as well  
20      as of course our risk committee when we reviewed  
21      this.

22                 So it's not just a, you know, margin is

1 the first defense but that's not the only thing.  
2 We are also looking at the items of stress testing  
3 and other items as well that I will talk about as  
4 they foreshadow the third committee.

5 MS. LEWIS: We will take two final  
6 questions and then we will break for lunch. The  
7 Chair recognizes Kathleen Cronin.

8 MS. CRONIN: I think that Mr. Bussey did  
9 a good job of summarizing the process where CME  
10 increased its margin so I won't repeat that. I  
11 will just observe that we were initially very  
12 conservative in terms of setting the margin for  
13 this product understanding public perceptions and  
14 concerns but quite comfortable that we provided  
15 for more than adequate margin to address the risk  
16 of the product.

17 I'll also just briefly address the  
18 implication from Paul's question about changing  
19 incentives for the exchange and the clearing house  
20 as we have become public and I think that has been  
21 discussed many, many times over the years since we  
22 became public and, you know, our obligations with

1 respect to risk management have not changed. Our  
2 obligations with respect to compliance with the  
3 core principles have not changed and so the fact  
4 that we are a public company if anything makes us  
5 more responsive to customer needs for risk  
6 management products but it does not change our  
7 approach to ensuring that integrity of our  
8 clearing house.

9 MS. LEWIS: The Chair recognizes Marnie  
10 Rosenberg.

11 MS. ROSENBERG: Thank you. So I sit  
12 within the risk management division of JP Morgan  
13 and we did a deep dive targeted review as CME and  
14 OCC both know because I have spent a lot of time  
15 with both organizations. And the question I have  
16 is how much does the CFTC staff engage with the  
17 FCMs that do bear ultimately through the default  
18 fund and the assessments, the risk. If a product  
19 were initially at launch products may have low  
20 volumes, small open interest but it's really hard  
21 to gauge at the outset how much that grows. So I  
22 would be interested in understanding how much the

1 staff engages with the reviews or consults with  
2 market participants in terms of work that they  
3 have done on some of these, some new products.

4 MR. KULKIN: So I would answer in sort  
5 of there's two tracks, right. So the first is the  
6 regular ongoing regulatory oversight so looking at  
7 levels, looking at capital, looking at SEG,  
8 looking at residual interest making sure that the  
9 cushion that is required to be there is there.  
10 Then, the second piece is really more of the --  
11 call it sort of anecdotal, where we reach out and  
12 we talk regularly with the FCMs particularly on a  
13 new contract, right.

14 With -- when these contracts were  
15 launched we were almost constantly in touch with  
16 either the NFA, the CME or specific FCMs and it  
17 was helpful to hear from them about how they were  
18 engaging with their customers, how they were  
19 deciding whether and how to facilitate trading or  
20 allow trading for their members, whether they were  
21 setting margin levels higher, if they were  
22 implementing any sort of trade size restriction

1 and, you know, anecdotally they were very  
2 conservative in this instance about how they  
3 approached that in terms of who they let in and  
4 who they didn't and also how they made sure that  
5 they had the adequate protections in place in the  
6 care of extreme volatility on the futures  
7 contract.

8                   And so, you know we both kind of had  
9 the, we had the quantitative and the qualitative  
10 data that we needed combined with the information  
11 from the exchanges and from the clearing houses  
12 that our colleagues had to get a better sense of  
13 what was happening at the FCM level.

14                   MS. LEWIS: Paul, anything?

15                   MR. ARCHITZEL: No, thank you for  
16 asking.

17                   MS. LEWIS: Okay. So at this time in  
18 keeping with the agenda we will break for lunch.  
19 Let's see. It's around, its 12:34 now so we will  
20 start again at 1:35. Please note there is a list  
21 of area restaurants on the agenda table.

22                   (Recess)

1                   MS. LEWIS: It's my pleasure to call the  
2 meeting back to order. I hope everyone is  
3 enjoying the Wassercakes that are in the back.  
4 And now we will have the third panel of the day,  
5 Futures Exchanges and New Products. And I will  
6 turn it over to Paul Architzel.

7                   MR. ARCHITZEL: So thanks very much.  
8 Let me introduce the panel. I think each panelist  
9 will be making a statement and then we will have  
10 an opportunity for discussion by the committee.  
11 So on the panel today we have Julie Winkler from  
12 the CME Group, Chris Concannon, president and  
13 chief operating officer of CBOE Global Markets,  
14 Trabue Bland who is with ICE Futures U.S. and Dale  
15 Michaels, Executive Vice President of Financial  
16 Risk Management at the OCC. So with that let me  
17 turn it over to Julie and please start.

18                   MS. WINKLER: Thank you. Good afternoon  
19 Commissioners, Mr. Chairman. My name is Julie  
20 Winkler and I am CME Group's Chief Commercial  
21 Officer where my duties include managing our  
22 research and product development team as well as



1       our digitization and sales functions. Thank you  
2       for the opportunity to participate today to  
3       discuss self-certification in the initial listing  
4       and clearing of commission regulated contracts.

5               We think it is important for the  
6       Commission to continually examine and assess  
7       existing processes to help in its mission that  
8       regulated markets operate in a transparent and  
9       efficient manner. Exchanges can list new futures  
10      by requesting Commission approval or by certifying  
11      that the contract terms comply with all applicable  
12      CFTC regulations. The new product process is  
13      collaborative and deliberative whether the  
14      exchange takes the route of prior CFTC approval or  
15      self-certification. The CFTC's role in either  
16      case is significant and substantive.

17             Exchanges make sure that the exchanges'  
18      staff is briefed on planned new products with  
19      unique contract design or regulatory elements so  
20      that the staff may identify any concerns. The  
21      commission staff has great experience in this  
22      area. Its views are valued highly by the

1 exchanges and this consultation process occurs  
2 within any planned new products with unique  
3 contract design or regulatory elements.

4 Today I would also like to share some  
5 information about how CME Group approaches the  
6 product development process. That is the work we  
7 do prior to listing or clearing a product. At CME  
8 Group we view the product development process as a  
9 mechanism for capturing, communicating and  
10 filtering product ideas with the objective of  
11 bringing commercially viable and regulatory  
12 compliant contracts to market.

13 At the ideations stage we conduct  
14 analysis to determine whether there is a unique  
15 client need for a new product and we evaluate both  
16 the structure and the trends of the underlying  
17 market. We also consider whether the market has  
18 an accepted benchmark that can serve as a  
19 contracts reference price and if not whether an  
20 available pricing data can support a new  
21 derivatives contract.

22 After the ideation phase this leads into

1 product feasibility review stage during which CME  
2 Group initially interacts with key market  
3 participants for the purpose of identifying  
4 contract terms and conditions. The product  
5 feasibility stage is followed by even more  
6 customer validation. At this stage we solicit  
7 customer feedback broadly to assess whether a  
8 product's proposed terms meet the demands of a  
9 variety of market participants.

10           The interaction with the market  
11 participants ensures that the product's design  
12 captures cash market convention. Another  
13 important component to the listing of the product  
14 is the ability to conduct risk management around  
15 that product. CME Group's internal risk  
16 management process is complimentary to the product  
17 development process that I previously described.  
18 CME Group's clearing house staff has vast  
19 experience in evaluating the risk profile of new  
20 products. In determining product risk profiles,  
21 CME Group's clearing house staff will review a  
22 product such as bitcoin referenced rate futures

1 with the relevant exchange business, product  
2 development and operations teams and they provide  
3 a comprehensive view on risk management issues.

4 Another essential component of our  
5 product launch process is ensuring that the  
6 product can be effectively monitored and  
7 surveilled. For instance, prior to a product  
8 being launched, CME Group's market regulation  
9 department works with the relevant product  
10 development, business, operations and clearing  
11 house teams to ensure that the new product  
12 reflects common cash market practices and meets  
13 CFTC core principles regarding susceptibility to  
14 manipulation.

15 Our market regulation department also  
16 works with CME Group product development staff to  
17 perform a deliverable supply analysis and  
18 establish position limits and or accountability  
19 levels for a new product. These limits and or  
20 levels give market regulation the ability to limit  
21 corner end squeezes particularly during the  
22 expiration of the contract. Additionally they

1 give market regulation the flexibility to monitor  
2 and dialogue with larger participants surrounding  
3 their positions and trading strategies.

4           Moreover, in addition to position  
5 limits, market regulation has a combination of  
6 tools to assist with its surveillance of the  
7 markets including reportable levels, existing  
8 trade practice reviews and market research reviews  
9 to deter and detect any activity that has the  
10 potential to violate our rules. Although some  
11 aspects of the above process are commercial, CME  
12 Group's product review procedures are specifically  
13 structured to satisfy statutory obligations as  
14 mandated by the Commodity Exchange Act and the  
15 Commission's Regulations.

16           For example, the procedures above are  
17 directly shaped by our statutory obligations  
18 including the limited authority to list for  
19 trading only contracts that are not readily  
20 susceptible to manipulation and that reflect cash  
21 market conventions. CME Group will consider  
22 bringing a new market -- product to market only if

1       it successfully navigates through these stages,  
2       the review and these procedures. I look forward  
3       to today's discussion and welcome any comments or  
4       questions from the Commission as well as the  
5       committee. Thank you.

6                   MR. CONCANNON: Mr. Chairman,  
7       Commissioners, committee members and guests. I'm  
8       Chris Concannon, president and COO of CBOE Global  
9       Markets. I would like to thank the committee for  
10      inviting me to participate today. I also commend  
11      the Committee for its willingness to review  
12      aspects of our market including the  
13      self-certification process.

14                   CBOE is a leader in providing global  
15      investors with cutting edge trading and investment  
16      solutions. In addition to our futures exchange  
17      CFE, CBOE operates six national securities  
18      exchanges consisting of four options exchanges  
19      including the largest U.S. options exchange and  
20      the four equity markets comprising the second  
21      largest U.S. stock exchange operator. CBOE also  
22      operates the largest European stock exchange and a

1 foreign exchange platform. We offer the  
2 industries widest array of products including  
3 securities options, futures, equities, ETFs, FX  
4 and proprietary index products such as futures and  
5 security options on the CBOE volatility index or  
6 VIX.

7           Obviously our most recent futures  
8 offering is a bitcoin futures product that has  
9 drawn some attention. Not much but some. Product  
10 innovation is what CBOE is all about. We engage  
11 in the process across multiple asset classes and  
12 it is a function and responsibility that we take  
13 seriously. Bringing a new financial product to  
14 market is complicated and it is a deliberate  
15 process. In most instances our first engagement  
16 is with our customers and our liquidity providers  
17 to assess the interest and the viability of the  
18 product. Oftentimes during this process we  
19 receive sufficient feedback and perform sufficient  
20 analysis to determine to not move forward with a  
21 product idea.

22           For products that make it past this

1 stage we routinely engage our regulators to  
2 discuss potential benefits and or concerns around  
3 the products including any impact to investors and  
4 the market place. For futures products this all  
5 takes place before the self-certification process  
6 is initiated. Thus, self-certification is the  
7 last piece in a long series of pieces that are  
8 involved in bringing a new futures product to  
9 market.

10 In terms of self-certification process  
11 itself, CBOE is quite comfortable that is a  
12 suitable mechanism to facilitate the introduction  
13 of new futures products and that it has served  
14 investors and the industry well since its  
15 introduction in 2001. We understand that the  
16 introduction of a bitcoin futures contract drew  
17 great attention however, the self-certification  
18 process worked exactly as intended. We applaud  
19 the Commission for sticking to the thoughtful  
20 regulatory framework it has designed for the  
21 introduction of new products.

22 It is important to note that many of the



1 concerns that were raised around bitcoin futures  
2 really had very little to do with  
3 self-certification. There was nothing about the  
4 CFE launch that caught parties by surprise. The  
5 perspective product launch was covered extensively  
6 in the press and discussed considerably with and  
7 by industry participants. We believe that the  
8 diligence that was put into the product's  
9 development and introduction was reflected by its  
10 successful launch. I thank you for the  
11 opportunity to participate and look forward to the  
12 discussion and any questions you may have.

13 MR. MICHAELS: Hi, I'm Dale Michaels  
14 from the Options Clearing Corp. First I applaud  
15 the Commission for putting this panel and this  
16 discussion together especially to bring the  
17 transparency to light of all the governance  
18 process that we have gone through at OCC with  
19 bitcoin.

20 I'm going to take a little bit different  
21 perspective from the exchanges. With the Options  
22 Clearing Corp., I'm taking it from a clearing

1 house perspective. I run the risk management area  
2 and want to give you a little bit of insight into  
3 the overall process we go through for a new  
4 product. First the Options Clearing Corp., we are  
5 the clearer for all equity options in the U.S.  
6 both broad based indices and single names. We  
7 also clear futures for CBOE futures, NASDAQ  
8 futures. We know a little bit about volatility  
9 with much of our single names risk and options on  
10 those.

11           With any new product what we look for is  
12 the risk management aspects around the product.  
13 What can we put in there to make sure that we have  
14 the proper controls in place? With a new product  
15 we are looking at is there anything new or novel  
16 about a product that we are bringing? Is it just  
17 an extension of an existing product which we see  
18 lot of the energy products or is this something a  
19 new asset class? If it is something that has been  
20 deemed as new or novel it goes through an internal  
21 and external governance process on the risk  
22 management surrounding those products.

1                   So let me give you a little bit of  
2                   insight into the bitcoin. With our margin model  
3                   at OCC, we use a STANS margin model. The CFTC  
4                   noted earlier today there is a minimum of a one  
5                   day period of risk for margins. At OCC we employ  
6                   a two day period of risk for margins, even a more  
7                   conservative standard than the minimums. We also  
8                   have an expected shortfall model. What that means  
9                   is rather than just looking at a 99 percent VAR  
10                  type of model, looking at all observations and  
11                  just cutting it off at 99 percent, we look at all  
12                  the tail risks so we look at 99 percent all the  
13                  way to 100 percent and average out those and we  
14                  are coming up with our 99 percent coverage levels.  
15                  It is another more conservative type of risk  
16                  management that we employ at OCC and what we are  
17                  employing today for bitcoin.

18                  When we looked at the margin model and  
19                  the volatility of the product, what we did is  
20                  looked at the at least two years of data when we  
21                  started off and did back testing to ensure that  
22                  our margin model can support the product. When we

1 looked at the back testing, did we cover 99  
2 percent at a minimum based on our standards of two  
3 day margin period of risk and our expected  
4 shortfall method? We found that it did and did so  
5 very routinely. We then went back and said well,  
6 two years might not be indicative of all the  
7 market's volatility that we have seen. So we went  
8 back in time and went to even further stress  
9 periods of bitcoins than what we have seen even  
10 recently. We went back to 2013 and stressed our  
11 model back then and see could we cover that type  
12 of volatility. We did exceed a 99 percent  
13 coverage on that piece of it as well.

14 We then went further and beyond these  
15 historical stress periods. We also looked and  
16 shared this information with our risk committees.  
17 This is something that we do on a, with any type  
18 of novel or new products as well and I will get to  
19 that a bit more in a bit. But this is, you know,  
20 part of the when we looked at the initial margin  
21 how we got first comfortable with the fact that we  
22 had the first line of defense of the initial

1 margin. And we are doing daily variation of  
2 course with any of the market moves so we are  
3 doing a daily variation but we are covering a two  
4 day margin and period of risk so we are taking the  
5 risk off the table each day.

6 We also then looked at the stress  
7 testing of the products. What is it that we need  
8 to incorporate for our clearing fund? We have a,  
9 our margin amount came out with about a 40 percent  
10 or so, a little bit above these days on a daily  
11 basis since we do calculate this on a daily basis  
12 as I mentioned earlier, every new day comes in we  
13 have a fresh volatility, we drop an old day. We  
14 looked at the stress testing and looked at how  
15 that might employ into our clearing fund and would  
16 that coexist with all the products that we have  
17 there? And what type of stress testing parameters  
18 do we need to have with our clearing fund for  
19 these bitcoin precuts? So we are stressing well  
20 over 100 percent going to the upside. Nearly down  
21 to zero on the downside.

22 And then we looked at how this fits into

1 the product set that we clear. Should this be in  
2 the single fund that we clear and this is another  
3 type of discussion that we have with our risk  
4 committee. Also look at the pricing of the  
5 products. Where are we getting the prices? What  
6 are the backups of the prices that we are seeing?  
7 What are the limits in other pricing structures in  
8 place? So that if there is an issue with the  
9 primary pricing source do we have other sources of  
10 prices that we can get? That's what we track. We  
11 continue to track to make sure that the pricing is  
12 consistent.

13 One thing to note is that since the  
14 bitcoin markets have launched at both CME and CBOE  
15 and looking at other venues where we see prices,  
16 the correlations have increased meaning that as we  
17 have seen more transparency being brought to the  
18 market by the clearing of these, we are seeing  
19 better price information out in the markets.

20 We also look at the default management  
21 capabilities that we can employ with the products.  
22 Who is going to be clearing these products? Who

1 are the market makers? Who can we talk to if we  
2 do have a problem on the -- if a clearing member  
3 does default and has these products in their  
4 portfolio? So we have ex ante an idea of about  
5 where to go with these types of products if there  
6 is default.

7           Overseeing all of this is the risk  
8 committee of our board. Our risk committee  
9 involves the clearing members that are clearing  
10 this product along with independents and it's a  
11 subset of our board of directors. They started  
12 looking at this back in July of this past year,  
13 looking at the same type of things that I brought  
14 out here earlier. They were looking at the margin  
15 model, they were looking at the back testing, they  
16 were looking at the stress testing, they were  
17 looking at the clearing fund. They had a  
18 particular interest in the pricing. This was not  
19 just one conversation but multiple conversations  
20 with our risk committee to get everyone involved  
21 and understanding of the risk management and  
22 approving the risk management that we had around

1       this product.

2                       Since the time that we have launched the  
3       product we have gone through an expiration, a  
4       seamless expiration in January of the product. As  
5       I mentioned we have seen volume and open interest  
6       both increasing at the CBOE and at the CME and we  
7       have seen consistent pricing, we have seen higher  
8       correlations in the pricing so all in all a very  
9       good first couple of months. And I should also  
10      mention as I mentioned earlier in the panel, when  
11      we talk to the risk committee, this information  
12      was shared with the CFTC. They were asking then  
13      the CFTC and at the SEC since they are also our  
14      primary regulator at the OCC on the risk  
15      management surrounding the bitcoin products. So  
16      all this back testing I talked about, the stress  
17      testing, the back testing going to more stress  
18      periods was all shared with the CFTC. Numerous  
19      types of discussions with both the CFTC staff and  
20      their more quantitative focus staff so they can  
21      understand what we are doing on the STANS margin  
22      model, on the back testing and the stress testing



1 and the default management around all of this.

2 Thank you.

3 MR. BLAND: Hi, I'm Trabue Bland, I'm  
4 president of ICE Futures U.S. We don't actually  
5 have a bitcoin contract but we do follow all the  
6 processes and procedures that my colleagues at the  
7 panel just discussed so I'm not going to add to  
8 what they said. I look forward to your questions  
9 and thank you for inviting us.

10 MR. ARCHITZEL: Thank you. I think  
11 perhaps the place to start the conversation in  
12 this segment of the MRAC meeting is around  
13 processes for stakeholder input to the extent that  
14 the Commission's process does not involve public  
15 comment and does not really have an opportunity  
16 for public participation, to what extent do the  
17 exchanges and the clearing houses have a process  
18 or provide for not only input from their risk  
19 committees but also their larger stake holder  
20 audiences?

21 MR. CONCANNON: Well, I will start.  
22 This process I would say was quite lengthy for us.

1 We spent about a year before the launch so over a  
2 year ago we started looking at the asset class  
3 that we call crypto. We had spent a number of  
4 months with many of the participants in that  
5 market. Most of our market makers on our futures  
6 exchange were already dealers in the crypto market  
7 so it was our clients that came to us asking for a  
8 derivatives contract that they could use so it was  
9 a solution created by clients at the outset of the  
10 discussions. We obviously had a lot of internal  
11 analysis of the product and the underlying asset  
12 class and then we moved into what we called the  
13 client interface phase.

14 Now we decided because of the nature of  
15 this product that we needed to announce our  
16 interests in the contract because we are a public  
17 company and it could have clearly material impact  
18 on stock prices. So we announced our interest in  
19 launching a bitcoin future contract and that's  
20 when we were able to more formally engage our  
21 clients and our FCMs that clear the product. So  
22 it was a lengthy conversation. In fact the

1 current construct of our product changed as a  
2 result of that interaction not only with our  
3 clients at first but then interactions with the  
4 CFTC staff. So we viewed this as a very formal  
5 process from the very beginning. And as a market  
6 to just surprise your clients and your market  
7 makers, your liquidity providers with a new  
8 product is a detriment to the launch of that  
9 product. It's just not recommended from a  
10 commercial standpoint putting aside your  
11 obligations as an exchange. So I viewed it as  
12 quite a lengthy process and the product that we  
13 designed and ultimately put in front of the  
14 Commission benefited from that interaction and it  
15 was months of interaction.

16 MS. WINKLER: Similar to the comments  
17 Chris was making, I mean, we at the CME were  
18 looking at this product for over two years. Our  
19 first conversation with the Commission about the  
20 index creation dates back to May of 2016 and the  
21 underlying index which is the reference rate for  
22 our contract was launched in November of 2016. So

1 the index itself had been out there for over a  
2 year and having that be out there then it became a  
3 great vehicle for us to solicit feedback from  
4 clients because again our intention was can we  
5 create a robust benchmark that follows IOSCO  
6 principles that can be used that is not readily  
7 susceptible to manipulation and is indicative of  
8 the cash market and trading activity.

9           And so throughout that year that we had  
10 the index out there many conversations, in fact  
11 hundreds of conversations and in depth meetings  
12 with clients about this similar to CBOE that  
13 helped us to modify and create the contract that we  
14 ultimately launched that was done in feedback from  
15 clients and firms, many conversations with  
16 clearing member firms as well. There is obviously  
17 some unique aspects of this and we believed that  
18 that was an important part of the process to, you  
19 know, solicit their input.

20           But that is how we design all of our new  
21 products. Client validation and the need that  
22 clients have for that product is the single

1 biggest driver for why we introduced this.

2 MR. BLAND: So we self-certified 163  
3 contacts last year. Every contract went before  
4 our risk committee at and I clear at two different  
5 clearing house, ICE Clear Europe and ICE Clear  
6 U.S. and it also went before the boards of both  
7 the clearing houses and the exchange. The -- even  
8 before we hit that just like everyone else, if you  
9 don't have people who are going to trade the  
10 products there is no reason to take it to that  
11 process. So we do extensive market analysis  
12 before we get to that and what you can see a lot  
13 of times when we file it with the CFTC it's a very  
14 extensive filing even for a self-certification.

15 MR. MICHAELS: And take it from the  
16 clearing perspective, at OCC we do a couple thigs.  
17 I talked a little bit about our risk committee  
18 that has an overview of these types of novel  
19 products. We also have a financial risk advisory  
20 group at the OCC which is consisting of clearing  
21 member firms, buy side and exchanges that when we  
22 come up with either model changes or governance

1 changes or novel new products that we bring this  
2 to get comments that's, those comments are brought  
3 in front of our risk committee to see if they are  
4 worth bringing into the process.

5 So for example we did recovery and wind  
6 down process, got many comments back, brought it  
7 up through a risk committee, made some changes  
8 into our overall process. So this is a committee  
9 that we solicit opinion. It goes to the proper  
10 governance bodies within OCC and can make changes  
11 to the end results.

12 MR. ARCHITZEL: So again this may be  
13 something that the committee members may have  
14 views on but a follow up question would be is  
15 there a role for the Commission with regard to the  
16 structure and formality of stake holder validation  
17 for new products before they are submitted to the  
18 Commission for self-certification?

19 MR. CONCANNON: I think the obligation  
20 sits with the exchanges to present some of the  
21 feedback that we have received part of during our  
22 process prior to self-certification. And in fact

1 that's some of the dialogue that we had with the  
2 staff. They want to know how did you come to this  
3 result, the product design so there is feedback  
4 coming into the CFTC as a result of our collective  
5 processes prior to submitting that  
6 self-certification form.

7 MR. BLAND: I think the process right  
8 now works very well. The CFTC staff is and I know  
9 this from dealing with multiple different  
10 regulators is the best bar none and this might be  
11 me as a former CFTC employee so I might be a  
12 little bit biased. But they are, they're very,  
13 very good. They look at these contracts when they  
14 come in and we do have discussions before and they  
15 are always great questions about whether we have  
16 thought it through and so I think the process  
17 works very, very well but that gives us the  
18 flexibility to innovate.

19 MR. MICHAELS: Let me just add on one  
20 final answer and there was a question that the  
21 CFTC explicitly stated to us, what was the  
22 feedback that we solicited from the community and

1 that's where you can go in and say we did have a  
2 financial risk advisory council that we have  
3 solicited that type of feedback. We do meet with  
4 members and many members around this table at the  
5 MRAC reached out to me with their credit  
6 counterparts within their different firms to ask  
7 questions and which we certainly will give any  
8 time to. We also talked to the futures  
9 organizations to make sure that they are aware of  
10 the risk management aspects around the products.

11 MR. ARCHITZEL: It's been reported in  
12 the press that there has been some suggestion that  
13 perhaps certain types of contracts should be  
14 subject to a separate clearing fund. And I guess  
15 the question is has that -- what thought has been  
16 given to that whether stake holders or clearing  
17 members think it's a good idea to have separate  
18 clearing funds and if so when would you have a  
19 clearing fund, separate clearing fund and how  
20 would that process look?

21 MR. MICHAELS: Well, I will take this to  
22 start off with since it seems right up my alley.



1 This was actually an explicit conversation at the  
2 OCC Risk committee, the idea of a separate  
3 clearing fund for novel or new products. With the  
4 launch we decided to go with a single clearing  
5 fund for a variety of reasons. We looked at the  
6 volatility of the product, the margining around  
7 it, the volatility was certainly consistent with  
8 some of the products that we clear now. We looked  
9 at the cost of separate clearing funds and the  
10 impact to the additional cost of the clearing  
11 funds, to the clearing members themselves.

12           So when, if you start breaking apart the  
13 clearing funds, you are increasing costs because  
14 you lose the diversification risk by having the  
15 one single clearing fund. So if I start breaking  
16 out single named equities versus index equities  
17 versus futures I'm going to have to come up with  
18 the worst loss projections for each of those  
19 clearing funds. That my clearing fund aggregate  
20 amounts will be greater than the single clearing  
21 funds amounts. That has capital implications for  
22 each for our clearing members because they are

1 often calling me quite frequently about the  
2 capital implications of the clearing fund and the  
3 overall cost.

4 So if we started breaking apart it is  
5 going to be increasing the cost to the industry,  
6 increasing the cost to the clearing members. That  
7 was a strong consideration that we looked at when  
8 considering whether to break apart into a separate  
9 clearing fund.

10 MS. WINKLER: From CME's perspective,  
11 you know, very similar to what was done at OCC  
12 there was, you know, a lot of analysis done around  
13 the risk profile of these contracts and while the  
14 volatility can look significant, when we put it in  
15 light of other things that we have cleared and  
16 cleared in terms of electricity contracts or even  
17 emerging market currencies those are actually more  
18 volatile than what we have seen with the bitcoin  
19 futures contract. And so, you know, we feel  
20 confident that the risk management we have around  
21 that the margin that we are collecting so at 43  
22 percent of notional our typical range for other,

1       you know, similar type commodities and the range  
2       of 1.5 to 4.6 percent.

3                   The bitcoin futures, you know, were over  
4       40 percent and at a percentage of, you know, the  
5       base initial margin, you know, we are collecting  
6       about 59 million for bitcoin futures today.  
7       That's off of 90 billion in the overall fund for  
8       base margin. So again that's point, you know,  
9       seven percent. We think this is definitely  
10      covering the risk, you know, it certainly was  
11      discussed but from all the characteristics, the  
12      fact that we had five years of back tested data  
13      that we were able to analyze, you know, we felt  
14      confident that we were going to be able and again  
15      this is a futures contract based on an index and a  
16      cash settled product that we handle hundreds of  
17      other products very similar.

18                   MS. LEWIS: The Chair recognizes Rana  
19      Yared.

20                   MS. YARED: Thank you. So this is a  
21      question I think mostly to the OCC and the CME  
22      because you run your own clearing houses. Where

1 does the tipping point occur in your mind where  
2 you do require a separate clearing fund? So,  
3 Dale, I appreciate your comment about like  
4 splitting out single name from indices and frankly  
5 like no one would ever suggest you do that because  
6 we think of the equities class as an asset class  
7 vertical, right. So you wouldn't want to split up  
8 the correlated component parts. But we have also  
9 grown up in a businesses for those of us who have  
10 spent a lot of time in FICC where active decisions  
11 were made by for example by the CME to put  
12 interest rate swaps separately from the futures  
13 and options pool where the LCH does the same with  
14 interest rates and FX and where ICE does the same  
15 with CDS.

16 And maybe we can say that they made that  
17 decision because at the point at which they  
18 started clearing there was a very active market in  
19 that product and they were able to size enough to  
20 say that should something go wrong in this product  
21 we would want to isolate it away from the more  
22 vanilla F and O pool. Appreciate that the bitcoin

1 futures don't start with that, you know, wall of  
2 open interest so to speak behind them but what is  
3 the criteria in your mind to make the decision to  
4 break it out versus not?

5 MR. MICHAELS: We looked at and compared  
6 versus the CME you had exchange traded derivatives  
7 in one class and then OTC interest rate swaps and  
8 OTC credit default swaps. There seemed to be a  
9 very bright line when those types of decisions  
10 were made. I mean, over the counter there wasn't  
11 a front end engines trading engines at the time  
12 that no interest rate swaps were going. Same  
13 thing with credit default swaps at the time when  
14 the clearing had started. There was different  
15 considerations on the margin period of risk  
16 looking at five days periods of risk in interest  
17 rate swaps and credit default swaps versus minimum  
18 of one day in the futures so it seemed to be to  
19 try to cram that into one pool seemed to be  
20 inconsistent. They had different risk management,  
21 they had different default management practices.  
22 The default management for OTC and credit default

1 swaps are required participation by each of the  
2 clearing members that does not happen on the  
3 future side or the options side in exchange traded  
4 derivatives.

5           So it is those types of considerations  
6 as far as do you -- what is the, you know, the  
7 ultimate thing is what are you doing for default  
8 management? What are you, you know, that is  
9 really what the, you know, when you start looking  
10 at the clearing funds what the different default  
11 management practices that would likely get you  
12 into a world of I need a different clearing fund.

13           When we looked at the bitcoin and looked  
14 at the default management that we would employ for  
15 an exchange traded derivative, it -- that's where  
16 it much leaned heavier towards keeping it the same  
17 fund.

18           MS. WINKLER: I think yes, I would echo  
19 what Dale said. I think it is about default  
20 management. It is just very different, you know,  
21 here we are talking about a cash settled  
22 instrument with reportable levels of one contract.

1 Our clearing house knows every single person that  
2 is holding a position. You know, we are in a  
3 position where clearing firms have the ability to  
4 use in line credit controls and, you know, disable  
5 down to the account level and so, you know, their  
6 ability as well as the clearing house's ability to  
7 quickly liquidate positions that, you know, would  
8 be a concern as well as that two day, you know,  
9 margin coverage, you know, makes it again appear  
10 so much more similar to all of the other futures  
11 contracts that we clear today and does not have  
12 those same risk characteristics of CDS and some of  
13 the other things you mentioned.

14 MR. ARCHITZEL: With regard to futures,  
15 would there be any novel contracts that you would  
16 think should be split out into a separate  
17 guarantee fund?

18 MR. MICHAELS: Very open ended question.  
19 I would have to look at the contract specs. It  
20 would have to be, would we be able to do a default  
21 management on it, would we be able to price it,  
22 can I risk and manage it in the same way that I do

1 the rest of the exchange traded derivatives. So I  
2 don't think I could answer that question without  
3 more data in pricing and how things are settled,  
4 how things if its cash settled versus delivered.  
5 Is it traded on a, you know, exchange traded  
6 platform or am I getting it over the counter?  
7 Those are the types of questions I would have to  
8 put forward and it's all about, you know, can I  
9 liquidate these products in the same way that I  
10 can liquidate exchange traded derivatives.  
11 Because when I have a default I'm going to through  
12 an auction process for a big portfolio and is  
13 there anything different about these products that  
14 I would have to think about separately than I do  
15 for my other products.

16 MR. BLAND: The clearing members are our  
17 partners and if they ask us to come up with a  
18 separate guarantee fund and they are going to  
19 support that and we think that the additional cost  
20 and expense of creating a separate guarantee fund  
21 is worthy of creating this new product then  
22 that's, we will do it. I mean, it really comes



1 down to what the clearing members what to do. And  
2 that's why we separate it out CDS into a separate  
3 clearing house.

4 MS. LEWIS: The Chair recognizes Thomas  
5 Coyle.

6 MR. COYLE: Thank you. I'm curious  
7 about convergence. I see the CME and their  
8 longstanding contracts and the process they go  
9 through to review the contracts that check the  
10 data to make sure there is convergence. I'm  
11 curious on the new products, two questions. Are  
12 there different metrics you use, different  
13 processes you make on the a new contract to make  
14 sure that the risk convergence between the  
15 underlying and the contract itself. Second of  
16 all, when you are cash settling a contract against  
17 an index, is there any analysis done within the  
18 index itself to see if there are any anomalies  
19 within the index that may skew the settlement.

20 Ms. Winkler: Thanks for the question,  
21 Tom. I would say there are some differences  
22 between how the review of a physically delivered

1 contract works and how an index based cash settled  
2 product works. In the case of the Bitcoin  
3 futures, our market surveillance team is watching  
4 that index every single day. We are getting all of  
5 the constituent data for that reference price and  
6 the reference price is published every single day  
7 at 4 p.m. London time. That is our time to look  
8 for where they may be anomalies. Where there may  
9 be a large trade or something that came in from  
10 one particular constituent exchange. Our index  
11 methodology is published and in doing so, we make  
12 it very clear when and what types of trades we  
13 will include as part of that reference price.

14 Part of this for us too is just making  
15 sure that while we are using four different  
16 constituent exchanges currently for that reference  
17 rate, there is obviously hundreds of other spot  
18 platforms out there today. So, part of the role of  
19 market surveillance and I know the CFTC is doing  
20 this as well among their staff, is monitoring what  
21 else is going on, on those other platforms and  
22 taking all of that information and data into

1 account. So, it is very similar to what we would  
2 do today with our energy products where maybe we  
3 use one particular PRA as the settlement price for  
4 that particular contract but there is another  
5 competing PRA that also offers it. We're  
6 constantly triangulating that data to ensure that  
7 we do have price convergence.

8 I think it was Dale that had mentioned  
9 it earlier, we are starting to see, now that we're  
10 almost two months into the launch, a narrowing  
11 basis between the futures markets and the cash  
12 markets. We obviously look at that very closely  
13 too. I'd say as we move towards expiration, all  
14 of that just gets heightened, frequent  
15 conversations with CFTC staff around these issues  
16 just to ensure everything runs smoothly. Because  
17 that convergence, whether it is a physically  
18 delivered contract or a cash settled, that's what  
19 matters most. That's the whole concept and key  
20 aspect of any product design.

21 MR. CONCANNON: Yeah, I'll just add, we  
22 have a slightly different product. Our settlement

1 price relies on an auction on an actual Bitcoin  
2 exchange called Gemini. We monitor that market,  
3 we have extensive regulatory sharing information  
4 agreements with Gemini so we see everybody and  
5 their behavior in both markets and then we settle  
6 against an auction event. Our most recent  
7 settlement just occurred. What we also do is we  
8 bound that settlement price by an index. So, not  
9 only do we have an auction but we make sure that  
10 that auction is priced correctly based on an index  
11 similar to the CME. The settlement was from our  
12 vantage point, quite successful on converting to  
13 that cash price.

14 MS. LEWIS: The Chair recognizes Glen  
15 Mackey.

16 MR. MACKEY: Thank you. Just a quick  
17 question with respect to the underlying markets  
18 underpinning the cryptocurrencies to some extent.  
19 So, as you're thinking about new product and  
20 product development where you have a distributed  
21 ledger type of currency or commodity that really  
22 has no regulatory construct and that the protocols

1 associated with the underlying commodity can be  
2 changed and modified. In the form of like a hard  
3 fork where you have Bitcoin and Bitcoin cash going  
4 into two underlying different products but should  
5 you have a derivative contract on that top of  
6 that. How do you think about that in the nature  
7 of differences between that and other commodities  
8 such as the natural gas the power contracts where  
9 the underlying market is regulated. You have  
10 different regulators looking at the physical  
11 markets themselves and the construct can't be  
12 changed instantaneously like that if there is a  
13 split or a decision that is not good for part of  
14 the market participants.

15 MR. CONCANNON: We spent a great deal of  
16 time with the staff of the CFTC on that exact  
17 issue. They were very focused on that issue early  
18 in the process. That was a discussion -- the fork  
19 policy, we all have fork policies around our  
20 products. How do we determine if there is a fork.  
21 The analogy you used, I think the better analogy  
22 is the currency market and currency futures. The

1 currency market is generally unregulated and  
2 governments can change their currency at whim.  
3 So, we deal with very similar issues with regard  
4 to the currency market today.

5 With that said, we spent and it's in our  
6 product specs. We did have to file fork policies  
7 and what we do with those fork policies, the key  
8 is also information sharing. Getting information  
9 from the various crypto markets and having sharing  
10 agreements in place. That is something that the  
11 CFTC staff asked for all of us to do.

12 MS. WINKLER: I think of maybe a few  
13 different examples that might be relevant here.  
14 Certainly, there is a lot of novel aspects of the  
15 virtual currency market but there also are other  
16 contracts that have been introduced and also  
17 self-certified in past years. One of them that  
18 comes to mind is just the emissions market. To  
19 the point that Chris just made, emissions  
20 contracts whether they are EUA or CER markets are  
21 created by a government mandate. So, similar to  
22 hard fork there's different vintages of those

1 contracts that get created. And with legislation  
2 changing, with government position on those  
3 changing, we had to be in a position that our  
4 futures contracts could also adapt to those.  
5 Similar to the EPA changing the RBOB contract.  
6 For us, launching a product really is just the  
7 beginning. As we said earlier this morning, we  
8 constantly have to evolve and make sure that we  
9 are performing contract maintenance and that we  
10 designed a contract that enables that type of  
11 flexibility to be introduced and evolves as the  
12 underlying market evolves.

13 I think the other parallel with the  
14 emissions market, some may recall there were  
15 similar things where people were hacking into  
16 these registries and stealing credits. Again, it  
17 didn't make those markets go away, there were  
18 still very active futures markets that existed on  
19 them, and the obligation of the DCMs and the DCO's  
20 were to monitor the risks and ensure that we were  
21 meeting our regulatory requirements which we were  
22 doing.

1                   MS. LEWIS: The Chair recognizes  
2                   Biswarup Chatterjee.

3                   MR. CHATTERJEE: Thank you for your  
4                   remarks. What I'd like to make a point about is,  
5                   we go back to the beginning and we started the day  
6                   discussing how transparency into the  
7                   self-certification process is really key to this  
8                   thing going smoothly and robustly. I think  
9                   Commissioner Benham, you mentioned about following  
10                  process and what we do and especially also what we  
11                  not do. As I hear remarks from all three of you,  
12                  it seems like you do have a process in place and  
13                  you used that process. Chris, you mentioned about  
14                  contract participants coming to you and asking you  
15                  to launch this contract. Dale, you mentioned  
16                  about discussing this extensively with the  
17                  clearing members and risk committee and Board. So,  
18                  to me stepping back, it seems like a process was  
19                  in place, a process was followed but what I'm  
20                  taken back and can't reconcile is, if this was so  
21                  long in the works, discussed extensively with  
22                  external stakeholders, parties, why was there this



1 kind of adverse reaction to the self-certification  
2 of this product.

3 I mean, this is probably another  
4 question to the rest of the MRAC as well. What are  
5 we doing wrong or what can be done better to make  
6 sure that if a process is being followed, you guys  
7 are being transparent about it, there are  
8 extensive discussions with the regulators. I  
9 certainly don't want more regulatory oversight and  
10 things that stamp out innovation. Where is the  
11 gap and how did this gap arise. The other way to  
12 frame it is, if we did seek input from the  
13 participants, are the people representing those  
14 participants not representing the market because  
15 of the structure of what committees they're in and  
16 stuff like that.

17 MR. CONCANNON: I'll start. I think the  
18 first gap that I noticed, first of all, I was  
19 surprised by the focus on self-certification.  
20 Having gone through the process, there was nothing  
21 that I felt self-certified about. We spent so  
22 much time working with the staff on this process

1 and I'm quite familiar with the SEC process and  
2 they don't have this concept of self-certification  
3 and it was identical. It was identical until the  
4 very end in the nature of the filing. So, I was  
5 surprised by the reaction to self-certification.  
6 I understood there was a great deal of focus on  
7 this Bitcoin topic. One thing I did notice and  
8 we're already heard it, the gap I noticed the most  
9 was the volatility of Bitcoin, the actual  
10 volatility of Bitcoin and the volatility that was  
11 reported in the press. That was the gap. And  
12 people believed what was reported in the press and  
13 treated it as though this was a toxic instrument  
14 and that was not what our members were experienced  
15 in trading.

16           So, in retrospect in looking at how we  
17 ran our process, a great deal of our conversation  
18 was with the liquidity providers and the end  
19 users, the market makers. We did talk to FCMS. We  
20 had extensive conversations with FCMS but probably  
21 at the front end of the process, I would have  
22 flipped it to FCMS first and liquidity providers

1 along the way. I think we were reliant on our  
2 liquidity providers to have that extensive  
3 conversation with their FCMs that they clear  
4 through and some of the didn't. So, that was  
5 probably the biggest problem with this, it was the  
6 press and the focus as well as the misinformation  
7 around the actual volatility of the product.

8 MR. MICHAELS: Just to add on there, I  
9 mean, I think it's a fair question. I was seeing  
10 the disconnect that I'm having is when I saw folks  
11 saying, well it seems like it was rushed. I was  
12 sitting there looking back at it and I'm like we  
13 started talking on this internally within our  
14 internal governance process in the first half of  
15 '17. I brought up this to our model risk working  
16 group which is comprised of OCC's risk management,  
17 the model validation, the enterprise risk  
18 management, legal, compliance. It went through  
19 that process, then it went to our risk committee  
20 starting in July, went back there in September.  
21 We've talked about this at a number of different  
22 forums. So, when I felt rushed, I don't know if

1 I've ever actually looked more at a new product  
2 than I did for this one and then I am hearing  
3 something is rushed.

4 I think there is something to be said  
5 and maybe we need to make sure that we have the  
6 right folks on the forums that we reach out to.  
7 Maybe it's a talk with each of the different  
8 clearing members and whether they have the right  
9 folks there. Whether everyone is aware of the  
10 forums that we reach out to make sure that they  
11 have proper participation. Maybe that is  
12 something that we can try to circle around and see  
13 if there are any gaps there.

14 MS. WINKLER: Just to add to that, I  
15 think it was one when we just looked at the actual  
16 financial markets, there was not a lot of  
17 volatility. Bitcoin was the one thing that had  
18 volatility and to Chris's point, that is what was  
19 getting all the hype. So, I think in that, what  
20 that prompted is different dialogues. I think the  
21 challenges is that even within some of the end  
22 users that were asking us for this product,

1 certainly at the FCMS, you couldn't be speaking  
2 with one voice in talking to a firm because there  
3 would be difference of opinions even within the  
4 firm. So, I do think it's a good point of saying,  
5 making sure that we are talking across the firm to  
6 various aspects, not just the business, the  
7 operations, or the clearing risk folks. Even  
8 sometimes within those same groups, they had  
9 different opinions.

10           The other difference that I noticed is  
11 typically at launch, we are ready with all of our  
12 clearing members for a product launch. In this  
13 particular case, we still don't have all of our  
14 clearing members that are offering this product.  
15 Many of them followed different internal protocols  
16 because of the hype that their executives were  
17 seeing on the news and witnessing every day. So,  
18 that process is still playing itself out as well.  
19 But we were in a position to say, we are not going  
20 to launch until we believe that we have enough  
21 participation from our firms as well as our end  
22 users. We felt we got that towards the launch but

1 I do think it certainly pays acute attention to  
2 who we're talking to and the diversity of opinions  
3 that need to be solicited.

4 MS. LEWIS: We're just going to take two  
5 questions. The Chair recognizes Michael Modlock.

6 MR. MODLOCK: Thank you. I just want to  
7 look beyond the self-certification into the road  
8 map of the product and when you move from cash  
9 settled into futures and listed and unlisted  
10 derivatives, trade life cycle events and  
11 post-trade and so on. Do you feel that there's an  
12 opportunity at the industry level to proactively  
13 explore some of the unintended consequences that  
14 might arise as these markets and products grow and  
15 evolve? And if so, how do you think that that  
16 might look?

17 MS. WINKLER: I think it is still to be  
18 determined. I think we've probably as we've kind  
19 of talked about earlier today, not seen anything  
20 that has quite had this hype. It has been so  
21 technology focused and maybe a bit abstract for  
22 many people to kind of get their heads around.

1 But I think digitization is coming and we all have  
2 to be prepared for it. We have to keep in mind  
3 though, our jobs as exchanges and clearing houses  
4 is to manage the risk of the derivative  
5 instrument. Our role is not to oversee the  
6 corresponding cash markets. But for us, watching  
7 those markets evolve, making sure we are in active  
8 dialogue. I think there is so many great  
9 opportunities because this is all people want to  
10 talk about. You can't go to any conference in any  
11 industry at this point in time, that this is not  
12 the topic of conversation. I think that will help  
13 it to evolve.

14 We are taking the perspective of taking  
15 this very slow. We are happy with being able to  
16 introduce the first product. This is something  
17 that is going to be a gradual process, I don't  
18 think it's something that's going to come fast and  
19 furious.

20 MR. CONCANNON: I'll just add that I  
21 think there has been more articles written than  
22 contracts traded thus far. I wish it was the

1 other way around. Looking at crypto currency, it  
2 is an asset class, let's be clear. Crypto  
3 currency is an asset class. There is over 1400  
4 crypto coins somewhere on the planet. We do see  
5 it expanding. We do see nation states moving into  
6 the crypto currency space and actual currencies  
7 being issued in crypto form. Some countries are  
8 piloting those cryptos today.

9 I also envision a world where companies  
10 will be issuing coins. If I think about Apple and  
11 the number of dollars that I give to Apple because  
12 of my kids downloads, I would like Apple to issue  
13 credits and coins back to me in the form of Apple  
14 coins. If you think about American Express and  
15 the rewards program, that is actually a virtual  
16 currency that we can only transfer back to  
17 American Express. I do envision a world where  
18 companies and countries will be issuing crypto  
19 coins. We need an underlying derivatives market to  
20 help support that to the extent they are freely  
21 traded.

22 I also think there will be an



1 international non-nation state active currency  
2 market in the crypto space. I don't know which  
3 one it will be but I do see that there is a large  
4 demand for that. It will ultimately get  
5 regulated. You're seeing regulation in Japan  
6 where some of the exchanges have been registered.  
7 At some point, there will be registration  
8 requirements here or there will be commercial  
9 needs for registration. So, I do think it's an  
10 active asset class that we as derivatives markets  
11 have to monitor and we'll grow with it.

12 MS. LEWIS: The Chair recognizes Ed Pla.

13 MR. MICHAELS: Thank you. A few of you  
14 mentioned default management and I'm just  
15 wondering, default management can potentially,  
16 depending on the circumstance, have two  
17 components. One could be the auction of a  
18 principal position or a set of principal positions  
19 and the second would be the porting of client  
20 positions if the default was for a clearing member  
21 clearing for clients. I guess the question is,  
22 how do you think about the adequacy of and

1 diversity of clearing members for a given product  
2 or set of products. It's true that the default is  
3 that from the give-up agreement the default is  
4 that when a product goes live it is live but it is  
5 probably also true that not 100 percent of your  
6 clearing members clear 100 percent of the products  
7 that are available on the various exchanges. How  
8 do you collectively or individually think about  
9 the adequacy and diversity of your clearing member  
10 set and whether they can support porting in a  
11 crisis.

12 MR. MICHAELS: So, we looked at the  
13 default management. Let me just say that it's not  
14 only the clearing member firms that we're looking  
15 at, it's also the buy side participants. If we  
16 are looking for auctioning off a book of a  
17 possible clearing member portfolio, we are looking  
18 for clearing members that could take on a  
19 portfolio. We're also looking at buy side  
20 constituents who may have an interest in taking on  
21 a portfolio. So, we engage in both of those. We  
22 test extensively with our clearing members on

1 default management tests. When we were looking at  
2 this product, we were interested in having a broad  
3 set of both clearing members that were looking to  
4 clear as well as buy side constituents that would  
5 be able to take on a portfolio. So, we know which  
6 ones have desks today that if we did have to  
7 liquidate or auction off a portfolio with Bitcoin,  
8 we would know who to call, where to go to. That  
9 was the most important point when we started  
10 talking about default management.

11 Today, we have a number of clearing  
12 members that are involved in the markets looking  
13 at the OCC on the Bitcoin. It's no longer a small  
14 segment. It's a number of clearing member firms,  
15 both the largest banks as well as retail focused.  
16 There is a diverse selection of different member  
17 firms that are participating in this market. It's  
18 not concentrated into one or two firms.

19 MS. WINKLER: We've had a similar  
20 situation to Dale. It has been a diverse set and  
21 we are still continuing to see more clearing  
22 members come on and offer Bitcoin futures as this

1 market has progressed. Some simply by the nature  
2 of the timing of the launches for CBOE and CME  
3 said December is not really a good time for us, we  
4 still have some internal approvals to go through,  
5 let's see how things play out, we will talk again  
6 in January. That definitely is something that we  
7 are seeing in the diversity of members that are  
8 coming in.

9           Obviously the liquidation of that is key  
10 and being able and default management procedures,  
11 testing of that, that's a key part of what we do  
12 for all of our contracts. But I would also say  
13 with just give ups, we appreciate the give up  
14 transactions and those agreements are very broad  
15 in nature. However, it is written in our rules  
16 that any clearing member can reject a trade from  
17 any other firm that they're not willing to accept.  
18 So, that backstop has always been there, it is a  
19 part of our rules and applies to Bitcoin futures  
20 as well.

21           MS. LEWIS: That concludes panel number  
22 three. Before we break, I'd like to turn it over

1 to the chairman for closing remarks.

2 CHAIRMAN GIANCARLO: Thank you, Alicia.  
3 It is only my closing remarks, you still have  
4 another panel. I apologize, I do have to go to  
5 another meeting and won't be able to attend that  
6 one. I just wanted to say two things. We have  
7 two very proud traditions here at the CFTC. One  
8 is that our Commissioners really embrace their  
9 roles as advisory committee sponsors. Two, that  
10 all of the Commissioners actively participate in  
11 those meetings and stay as long as we're able and  
12 participate and actively listen. I think today as  
13 the first advisory committee meeting of 2018 and  
14 the first one of the new commission, I think you  
15 can see both of those traditions very much in  
16 effect. Since the tone in most organizations  
17 comes from the top, it then filters down. We've  
18 got a very good showing of commission staff here  
19 and most importantly, a great turn out from  
20 advisory committee members, great participation  
21 and great dialogue.  
22 I thank all of you for this. I think this is one of

1 the things that we do very well at CFTC. We take good  
2 input, we listen, we reflect on that and hopefully  
3 that comes out as good policy from the Commission  
4 going forward. We will certainly take a lot from  
5 today and think about that and reflect that back in  
6 due course. Thank you all once again. I thank my  
7 fellow Commissioners. I know they're looking forward  
8 to your last panel and I look forward to hearing about  
9 it later on. Thank you all very much.

10 MS. LEWIS: At this time, we'll take a  
11 ten minute break. Please be back at 2:50.

12 (Recess)

13 MS. LEWIS: The meeting is called back  
14 to order. And now we'll have the final panel of  
15 the day, Regulatory and Policy Approach for Novel  
16 Products. I'll turn it back over to Paul  
17 Architzel.

18 MR. ARCHITZEL: Thank you. So, our  
19 panelists on this panel are Albert S. Kyle,  
20 Charles C. Smith, Chair Business of Finance  
21 University of Maryland Robert H. Smith School of  
22 Business; Edward Pla, Futures Industry

1 Association, Managing Director Head of Clearing  
2 and Execution for UBS; and Kari S. Larsen, Counsel  
3 at Reed Smith. So, with that I'll ask each of you  
4 in turn to make an introductory statement and then  
5 we'll have questions.

6 MR. KYLE: Okay I will go first, I'm  
7 Pete Kyle. Thank you for inviting me to make  
8 comments about novel financial products. What I  
9 would like to do is take a step back in time to  
10 1979 and 1980 when you had the Hunt Brothers  
11 operating in the silver market. The reason for  
12 thinking about that is that Bitcoin has many of  
13 the same aspects as silver. It is kind of money  
14 like, it is kind of a stored value. It is very  
15 speculative and it can be moved around in certain  
16 ways.

17 So, when silver futures started trading,  
18 I don't think anybody thought of them as posing a  
19 systemic risk to the economy. But when the Hunt's  
20 cornered the market, silver became extremely  
21 volatile. Any risk management, any backward  
22 looking historical risk management exercise that

1 had been carried out became irrelevant. You had 14  
2 days in a row where there were limit up moves, I  
3 think there was one day towards the end when the  
4 price collapsed about 50 percent in one day. Even  
5 though people would not have thought it might  
6 happen, the Fed was the one that actually got  
7 involved by turning off credit to finance  
8 commodity speculation, made the Hunt silver corner  
9 unravel. The FCMs during this process discouraged  
10 their customers from trading silver futures and  
11 many of them prevented their customers from  
12 trading silver futures.

13           The Hunt Brothers themselves used hidden  
14 ownership technique. This is one of the parallels  
15 of Bitcoin is figuring out who owns it. They hid  
16 the ownership of the people they were cooperating  
17 with. In those days, it was through Swiss secrecy  
18 laws that they were exploiting and it took the  
19 CFTC many years to unravel actually who owned what  
20 and what had happened. It wasn't until several  
21 years later that the CFTC, through a lot of work,  
22 was able to figure it out.



1                   There was a very close connection  
2           between the cash market and the futures market.  
3           So, if you focused on the manipulability purely of  
4           the futures contract, you would have been in  
5           trouble in 1979 and 1980 because the Hunt Brothers  
6           cornered the entire silver market and their  
7           activities in the cash market were very important.

8                   So, there are a lot of things to  
9           remember about that episode. So, the question  
10          here is what is novel. I'm going to phrase it as  
11          what is novel about Bitcoin. There are several  
12          differences that make the Bitcoin situation  
13          different from the situation of silver in the  
14          1980's. The first is that Bitcoin is a cash  
15          settled instrument so you have to pay careful  
16          attention to how the cash settlement process  
17          works. What we heard earlier was that the CFTC  
18          does not like to see big aggressive trades taking  
19          place right at the end of trading during the  
20          settlement period. This could be big aggressive  
21          trades in the cash markets or in the futures  
22          market but most likely in the cash market.

1                   I would like to point out that if you  
2                   were the Hunt Brothers, if you were cornering  
3                   Bitcoins, one technique that you might use is to  
4                   set up some big short positions in the futures  
5                   market through a company that was as thinly  
6                   capitalized as possible and then just let the  
7                   short positions expire. So, you do nothing when  
8                   the contract cash settles. But by letting those  
9                   contracts expire, you will actually put huge  
10                  upward pressure on the prices because the cash  
11                  settlement process, in effect, buys your position  
12                  in even though you actually do nothing. So, if a  
13                  person with a large long position in the cash  
14                  market that you don't observe pulls their Bitcoins  
15                  off the exchanges or has a severed entity with  
16                  which Bitcoins are owned, they can pull off a  
17                  corner and appear not to be doing much of anything  
18                  as they pull it off.

19                  Bitcoin is different in that it's even  
20                  harder to figure out who ultimately owns the  
21                  Bitcoins then it is to pierce the Swiss secrecy  
22                  laws. I think this is something that should be

1 kept in mind. Finally, Bitcoin is novel in that  
2 the fundamentals of supply and demand just kind of  
3 aren't there. It is some sense a purely  
4 speculative type of commodity. It can be mimicked  
5 by others and it is very difficult to  
6 scientifically or apply economic principles to  
7 figure out what the fundamental value of Bitcoin  
8 is. In something like silver and most other  
9 commodities that we see, there is some kind of  
10 fundamentals to supply and demand that make them  
11 worth something or not worth something. Let me  
12 stop there.

13 MR. PLA: I'd like to start by thanking  
14 Commissioner Benham, Chairman Giancarlo and  
15 Commission Quintenz for featuring this important  
16 topic in today's meeting of the Market Risk  
17 Advisory Committee, we appreciate it. My name is  
18 Edward Pla and I'm the global co-head of execution  
19 and clearing for UBS. Today, I speak on behalf of  
20 the FCM clearing community of the FIA.

21 Today's agenda explores the manner in  
22 which new and novel products are self-certified

1 for listing by exchanges. The recent  
2 self-certification of Bitcoin futures in December,  
3 have given this committee a prime example to  
4 discuss and consider. FIA strongly supports the  
5 self-certification process as enacted by the  
6 Commodity Futures Modernization Act, as well as  
7 the goals of responsible innovation and fair  
8 competition as set out in the CFTC's mission.  
9 With that responsible innovation in mind,  
10 self-certification provides exchanges with an  
11 important tool to come to market with new products  
12 after certifying that they have fulfilled their  
13 statutory responsibility as set out in the core  
14 principles of the act and CFTC regulations.

15           These core principles require exchanges  
16 to attest that important safeguards and  
17 requirements are in place before the launch of the  
18 product to ensure these contracts are indeed,  
19 furthering responsible innovation and not  
20 endangering the marketplace. While Congress  
21 provided exchanges with the extraordinary power to  
22 self-certify its products, this self-policing

1 authority comes with reciprocal responsibilities  
2 that exchanges act in the best interest of the  
3 marketplace.

4 Today, I'm representing the members of  
5 the clearing member community that play a pivotal  
6 role in the clearing of these products and the  
7 reduction of systemic risk in the markets. By  
8 margining and guaranteeing customer trades,  
9 contributing to the guarantee funds of clearing  
10 houses and committing to assessment obligations  
11 during clearing house shortfalls, clearing members  
12 of the foundation of the clearing system. One of  
13 the primary benefits of clearing is its  
14 socialization of risk through the clearing member  
15 default fund. This mutualization of risk protects  
16 the integrity of the financial system from  
17 contagion but also requires clearing houses and  
18 their clearing members to strict requirements  
19 about the creditworthiness of market participants  
20 and the risk managements of the products that are  
21 cleared.

22 This is due to the fact that clearing

1 members are exposed to the risk of all market  
2 participants during a default. No matter whether  
3 the specific FCM is clearing the product or not.  
4 Clearing members cannot firewall themselves away  
5 from the risk of others in the clearing system. A  
6 sharing of fellow customer risk is the basic  
7 tenant of clearing that helps disburse and  
8 distribute risk.

9           With several exchanges announcing last  
10 fall that they would launch Bitcoin products,  
11 there were various opinions within the industry  
12 about the riskiness of the products and how to  
13 properly manage the exposure. These are by no  
14 means, standard product announcements. Even the  
15 CFTC and the NFA issued public statements  
16 regarding the potential volatility of the  
17 underlying crypto currency products. The FCM  
18 community believes that the launch of these new  
19 exchange traded derivatives and crypto currencies  
20 would have benefited from more two way dialogue  
21 among regulators, exchanges, clearing houses and  
22 the clearing firms who will be absorbing the risk

1 of these instruments during a default.

2           Unfortunately, the self-certification  
3 process as discussed, is constrained in allowing  
4 for market input and in this instance, there was  
5 only minimal and formal discussion of clearing  
6 members, depriving the process of critical  
7 information on certain key questions. Such as,  
8 whether a separate guarantee fund for these  
9 products was appropriate or whether the exchanges  
10 should put additional capital in front of a  
11 clearing member guarantee fund. Whether the  
12 underlying cash markets are adequately regulated  
13 and liquid to support the settlement process for  
14 these contracts and whether the products are  
15 properly margined.

16           FIA applauds Chairman Giancarlo's  
17 announcement two weeks ago to improve the  
18 self-certification process by requiring exchanges  
19 to show that the industry was properly consulted  
20 before the launch of such crypto currency  
21 products. Specifically, exchanges will now be  
22 asked to disclose to the CFTC what steps they have

1 taken in their capacity as SROs to gather and  
2 accommodate appropriate input from concerned  
3 parties including trading firms and FCMS. This  
4 must be more than a check the box exercise and  
5 allow for a healthy and rigorous dialogue with  
6 market participants, similar, the process for  
7 exchange rules. Exchanges and CCPs should be  
8 required to include in the self-certification  
9 submission, the comments received by the industry  
10 and how they were addressed. This would add  
11 accountability to the self-certification process  
12 and provide the CFTC with assurances that the core  
13 principles are being met.

14 We also believe that the crypto  
15 currencies are not the only novel product class  
16 that may benefit from further marketplace  
17 engagement. We should not artificially limit the  
18 discussion to the topic of Bitcoin. We believe  
19 the clearing members and other market participants  
20 should be consulted on any novel product that  
21 poses unique risk challenges to the markets  
22 regulation.



1           It is quite possible that had these  
2           enhancements been in place and the industry  
3           properly consulted, we would have ended up in the  
4           same place. However, the added transparency and  
5           process would have brought confidence and  
6           certainty that these products were adequately  
7           designed and risk managed to succeed. It is our  
8           understanding that the CFTC also plans to look at  
9           how exchange governance oversees the launch of  
10          these novel products. Just as regulatory  
11          oversight committees provide an independent voice  
12          on exchange boards regarding regulatory issues, it  
13          is equally important that exchange governance be  
14          constructed to ensure that risk issues are  
15          properly being debated and addressed.

16                 In conclusion, we do not believe it is  
17          the role of government to direct the business  
18          decisions and the markets it regulates. However,  
19          we commend the Chairman and the commission for  
20          their willingness to reflect on the recent Bitcoin  
21          futures launch, evaluate lessons learned and  
22          consider ways to make the existing

1 self-certification process even better. I  
2 appreciate Chairman Benham and the advisory  
3 committee's willingness to discuss this important  
4 matter as part of the MRAC agenda. Thank you.

5 MS. LARSEN: Thank you Commissioners.  
6 My name is Kari Larsen. I'm counsel with Reed  
7 Smith in the commodities group and an co-head of  
8 the Global Fintech Practice Group. I focus my  
9 practice on innovative products and Fintech  
10 regulatory and transactional matters. I began my  
11 career in the CFTC's chief counsel's office in the  
12 enforcement division and then went on to become  
13 the general counsel of an environmental futures  
14 exchange called Green Exchange. Following the  
15 acquisition of Green Exchange by CME Group, went  
16 on to be the general counsel at Ledger X, a SEF  
17 and DCO that offers and clears swaps and options  
18 on digital currencies.

19 I now advise numerous clients on over  
20 the counter and exchange traded crypto currency  
21 products and represent a number of Blockchain  
22 based or crypto related platforms. I've spent a

1 significant portion of my career both as an  
2 outside lawyer and as an inside counsel evaluating  
3 novel products, examining how to trade them, how  
4 to properly affect and document transactions, how  
5 to affect physical delivery, how to perfect a  
6 security interest and other novel issues. In the  
7 early 2000s, I helped clients develop telecom and  
8 weather derivative products and I particularly  
9 specialized in environmental commodities  
10 representing ISDA and drafting the U.S. emissions  
11 annex and assisting clients in the U.S. and EU  
12 carbon markets and renewable energy markets.

13           Novel products can present novel  
14 challenges. But in my experience, there are more  
15 similarities in how these products progress and  
16 work within the commodities markets than there are  
17 differences. They start to operate in small  
18 illiquid markets with fewer players. They almost  
19 always begin in a physical environment with  
20 industry specific traders that may be unfamiliar  
21 with derivatives markets on the whole. The OTC  
22 market is extremely important in the beginning

1 stages of these products because it permits new  
2 transaction types to emerge. Over time, they  
3 become sufficiently standardized ideally to  
4 support migration to an exchange. Often, it can  
5 take an exchange, as discussed in some detail in  
6 our prior panel, six months to a year or more to  
7 bring a product to market. There is significant  
8 research and analysis involved, internal and  
9 external legal and consultant review, new  
10 technology and testing, marketing and sales and  
11 risk analysis. For anything other than a simple  
12 change or addition to an existing contract, it  
13 includes meetings with CFTC staff. For novel  
14 products, the challenge is even greater as it also  
15 requires market education, additional CFTC  
16 meetings and connecting new participants.

17           However, my experiencing has shown me  
18 that these products, the principle based  
19 regulation allows enough flexibility to encompass  
20 and address novel products. They do operate  
21 similarly. Crypto, for example, may have some  
22 unique characteristics as has been discussed

1       today. But it has progressed and it has progressed  
2       through the trading stages very swiftly in  
3       comparison to some other previous unique products.  
4       It trades and operates like any other commodity.  
5       It was created like the sulphur dioxide allowances  
6       were created by legislation and regulation. It  
7       can be volatile as can be rhodium and palatium.  
8       Some crypto, like Bitcoin, operates as a store  
9       value or an investment, not unlike gold. And like  
10      emission allowances, some tokens provide a  
11      intangible right to a good or a service. Physical  
12      delivery is accomplished on a digital ledger,  
13      similar to other exempt commodities like carbon  
14      credits or regs.

15                 It wasn't that long ago that the  
16      Commission wasn't certain about the environmental  
17      products and where emissions fit into the existing  
18      regime. Along with the Dodd Frank regulatory  
19      proposals, the CFTC included a number of questions  
20      to the market that indicated staff was considering  
21      whether emission allowances should be considered  
22      swaps. Comments overwhelming disagreed with that

1 proposal and discussed how allowances can be  
2 consumed, used for compliance, used to be good  
3 actors and were more than just a financial value  
4 transfer. The final rules agreed stating the  
5 intangible nature of environmental or other  
6 commodities does not disqualify contracts based on  
7 such commodities from the forward exclusion from  
8 the swap definition.

9           Crypto currencies and assets have the  
10 same intangible nature as will future products to  
11 come that we have yet to imagine but still can be  
12 handily addressed by principle based regulations.  
13 I also suggest that crypto's characteristics may  
14 soon lend themselves to many more products. We  
15 continue our march toward digitization. Cash and  
16 FX are digital markets themselves. Cyber security  
17 is one of the most important risk measures of our  
18 age. The technology advances likely will have  
19 more effect on policy and may require some rule  
20 revision as we progress as exchanges move to  
21 distributed systems and clearing may be  
22 accomplished via smart contract. I look forward

1 to the challenges that these new technologies and  
2 products will bring and I look forward to our  
3 discussion.

4 MR. ARCHITZEL: Thank you. I think a  
5 few questions arise at this point. One is, is the  
6 current process, the self-certification process  
7 appropriate for new and novel contracts.

8 MS. LARSEN: As I said, I think how  
9 products currently come to market for all products  
10 unless it is a simple month addition, goes through  
11 a process even with the self-certification. It  
12 involves meetings with members, it involves  
13 meetings with participants, it involves meetings  
14 with staff. There is a process in place. I think  
15 that most people are comfortable with that process  
16 but that's not to say that there can't be  
17 improvements to that process.

18 MR. PLA: I would say it almost is a  
19 function of the concept of novelty. I don't  
20 novelty is binary, I think it is a continuum. The  
21 question is, at the most novel, complex end of  
22 that spectrum, is the process adequate. I think

1 the question is, maybe the answer is, should there  
2 be more regulatory engagement. Should there be  
3 the potential for a circuit breaker in that  
4 self-certification process. To ensure that the  
5 views and the considerations brought by a variety  
6 of stakeholders, trading firms, clearing members,  
7 regulators and users are all taking into account  
8 in product design and risk management.

9 MR. ARCHITZEL: So, I think that leads  
10 to the next question which is, how do you define  
11 what is novel and complex or what is novel and  
12 where along that continuum does the more in-depth  
13 process kick in? I think in retrospect, looking  
14 at Bitcoin, everyone can agree well that's a novel  
15 instrument. The next one coming down the line,  
16 how would you identify what's a novel instrument  
17 which should be subject to additional or  
18 heightened review.

19 MR. PLA: You know it when you see it.  
20 I think there are probably a few factors that we  
21 could consider. If you start to say, that factor  
22 exists with this product, then maybe you're at the



1 more novel or complex end of the spectrum. A few  
2 that comes to mind would be, the product has  
3 limited price history. So, even though we're  
4 going to do lots of statistical analysis, even a  
5 couple years of price history might be pretty  
6 meaningless in the history of financial markets.  
7 Maybe historical prices are volatile and/or there  
8 are price discontinuities. So, if you have the  
9 combination of volatility and gap moves, so to  
10 speak, maybe that's an indication of poor  
11 liquidity. So again, you've got limited price  
12 history, the price history you have could be  
13 volatile and priced as continuous so suggesting  
14 the possibility of lack of liquidity. Maybe the  
15 product is one that we think has the potential to  
16 introduce meaningful new risk to the clearing  
17 member community. Maybe not at the outset, because  
18 as you said, correctly most products start slowly  
19 and then grow. But if it has the potential to  
20 materially impact that mutualized risk pool, have  
21 we considered the implications and the safeguards.

22 I know there might be settlement

1 operational risks. So, is there anything unique  
2 about the settlement process that introduces  
3 dependencies, operational risks that could become  
4 problematic. And does the product dominantly  
5 appeal to a niche client segment. So, if that's  
6 true, does that mean that there is going to be a  
7 very small subset of clearers who are willing and  
8 able to clear the product. And then, how might  
9 that affect the ability to port client positions  
10 in that product in a crisis. I don't think that's  
11 an exhaustive list, it's meant to maybe kickoff  
12 discussion but I think those are probably factors  
13 to consider.

14 MS. LARSEN: I agree. It is primarily  
15 important that it not be because it is a volatile  
16 product. A lot of products are volatile and that  
17 is part of why there are futures contracts offered  
18 on these products. To look at the default risks  
19 involved and if it operates differently or  
20 calculations would need to be significantly  
21 different and it would be a unique bucket, I think  
22 that's something that would be worth

1 consideration.

2 MR. KYLE: I think from the CFTC's  
3 perspective, something important to think about is  
4 whether the staff of the CFTC would have the  
5 capability to sort out some kind of mess or  
6 scandal that wound up being dumped into the laps  
7 of the CFTC as a result of something going wrong  
8 with a new product. So, if it is something like a  
9 different agricultural product or a different  
10 metal, something that the CFTC is used to dealing  
11 with, it may not be that novel. But if it's  
12 something like a crypto currency and the CFTC were  
13 asked to sort out some kind of bankruptcies or  
14 financial disaster that occurred by doing some  
15 forensic research, would there be any expertise at  
16 all within the organization to actually do it.  
17 And I'm guessing the same thing I'm saying about  
18 the CFTC applies to the exchange itself. That it  
19 would be novel from an exchange's perspective if  
20 the exchange did not have the ability to work its  
21 way through problems that might occur in its own  
22 contract simply because of lack of familiarity and

1       lack of expertise.

2                   I want to take a little bit of issue  
3       with something that was said earlier. This is the  
4       idea of running new financial products by the  
5       existing people in industry who might be affected  
6       by those products. I think if that would have  
7       happened completely in the 1970s, we would never  
8       have gotten financial futures. I think the  
9       finance industry was threatened by financial  
10      futures and it didn't want it. It kind of got it  
11      anyway and it was a good idea that came about in  
12      the 1970s precisely because the futures exchanges  
13      were kind of going out and doing their own thing  
14      without a lot of support from the dealer  
15      community.

16                   MR. ARCHITZEL: So, that raises an  
17      excellent question and an interesting problem and  
18      that's the concern of stakeholders wanting to be  
19      involved in the launch of new products and the new  
20      products potentially being disruptive to the  
21      existing industry. So, how does one balance those  
22      two somewhat competing aspects.

1                   MR. KYLE: Let's go back to onion  
2 futures. I think there was a lot of -- onion  
3 futures were not allowed in the U.S. I think if  
4 you look closely at it, you'll find the reason was  
5 the dealer community didn't want the transparency  
6 and the ability of smaller participants to kind of  
7 see what was going on in the market.

8                   So, one of the advantages of futures  
9 markets is that they are transparent and easily  
10 available for all to see what is going on. What  
11 that does is that levels the playing field.  
12 Leveling the playing field is bad for the people  
13 who have the playing field tilted to their  
14 advantage and it is good for the people who don't  
15 have the playing field tilted to their advantage.  
16 The part of the innovative nature of futures  
17 markets is that innovation may adversely affect  
18 entrenched interests that want to protect what  
19 they have.

20                   MS. LARSEN: It is a balance because in  
21 an exchange, essentially what you're taking about  
22 is a commercial product from an exchange. It is

1 proprietary and there is going to be delicate  
2 aspects to the product and the calculations and  
3 the analysis. But part of that is interacting  
4 with members and with users and figuring out  
5 demand and figuring out how to best craft the  
6 product that will have the best appeal. But those  
7 are commercial matters which is different from the  
8 risk analysis. That and the clearing house  
9 working with the member is really going to the  
10 risk assessment. So, I think there is two  
11 separate buckets that have to be kept in mind.  
12 Some of it is to establish whether there will be  
13 activity and some of it is to establish the risk  
14 parameters. I think it is very hard to dictate  
15 that. I think that that's something that the  
16 exchange has to evaluate and as part of the  
17 process, part of the discussion has to discuss  
18 with staff and see where there is comfort level or  
19 not. It is hard to put metrics on it.

20 MR. PLA: I think the client clearing  
21 service is fee based market access service. I  
22 think the way most firms would look at new

1 products is they prioritize based on client  
2 demand. So, it's probably fair to say that as new  
3 products are introduced, if an exchange or  
4 clearing house is detecting demand, there is  
5 probably reciprocal demand being detected by  
6 clearing members trading firms who take the other  
7 sides of those trades.

8 MR. ARCHITZEL: Professor Kyle, you  
9 discussed silver as having some parallels to  
10 Bitcoin. But the example is a little bit different  
11 in that silver had been trading for many years and  
12 was an accepted futures contract without people  
13 really thinking of it as being particularly  
14 problematic. How does that example correspond to  
15 Bitcoin where it is a newly introduced contract  
16 and how does the example that you could have  
17 potential for manipulation based upon a parallel  
18 analysis. How does that affect the process one  
19 would use to introduce a new contract?

20 MR. KYLE: So, I think that there are  
21 some parallels, there are some things that make  
22 Bitcoin novel compared to silver. One of the main

1 differences is that silver was not only physically  
2 delivered but some of the delivery facilities were  
3 right there at the exchanges where the exchanges  
4 could keep an eye on what was going on with regard  
5 to delivery on a daily basis because it was  
6 essentially part of their business. And Bitcoin  
7 is quite different in that the ultimate cash  
8 market for Bitcoin is quite separated from the  
9 exchanges. Because of that separation, I think  
10 that's why you have the cash settlement rather  
11 than the physical delivery that the exchanges  
12 would like for there to be a seamless relationship  
13 between the cash market and the futures market.

14           But there kind of intrinsically isn't so  
15 you use this cash settlement mechanism to try to  
16 build a bridge between the two. That cash  
17 settlement mechanism creates things that are novel  
18 relative to silver but, of course, not relative to  
19 other futures contracts which are also cash  
20 settled. But I think that many of the issues that  
21 are related to cash settlement have not been  
22 sorted out from a regulatory perspective, even



1 within the CFTC or even within the legal way in  
2 which they're regulated because the ability to  
3 corner or squeeze or otherwise manipulate a  
4 contract is not solved by cash settlement in any  
5 way. Many people believe that somehow cash  
6 settlement makes these problems smaller or even  
7 make them go away. It doesn't make them smaller,  
8 it doesn't make them go away. The problems of  
9 manipulation in the forms of corners and squeezes  
10 are exactly the same with and without cash  
11 settlement.

12 MS. LEWIS: The Chair recognizes  
13 Sebastiaan Koeling.

14 MR. KOELING: Thank you. I'm here  
15 representing a group of proprietary trading firms  
16 so I figured it would be a good idea to also give  
17 a perspective on what we do with regards to new  
18 products that enter the marketplace. Typically,  
19 when exchanges come up with ideas to bring new  
20 products to the marketplace, I think they do  
21 indeed try to reach out as much as possible to the  
22 stakeholder group. I think Jerry eluded to that

1 early on. They're looking for firms like ours to  
2 provide liquidity and new futures, new options  
3 that are out there. So, they typically ask us  
4 about a lot of different things. What do we think  
5 about the product specs, what do we think about  
6 contract size, all those kinds of things.

7 In return, we ask questions back. We  
8 say, okay what kind of interest is there out  
9 there. What kind of end users are there that are  
10 interested in trading these kinds of products.  
11 How are you going to measure risks and things like  
12 that. Are there clearing firms out there that are  
13 willing to clear these kinds of products. So, I  
14 think where we're looking at this problem of new  
15 products through the same eyes probably as  
16 exchanges, we're looking for a long term success  
17 for a product. We're going to be able to trade  
18 these products in a long term, provide liquidity  
19 which is, in the end, our business model. I think  
20 our alignments are exactly the same as an exchange  
21 that is looking to create a long term sustainable  
22 product. Not only on the commercial side, I think

1       you split the product between the risk side and  
2       the commercial aspects. I think they're looking at  
3       that from a risk perspective too and I would argue  
4       the same goes for firms like us which is why, from  
5       my perspective, the self-certification still makes  
6       a lot of sense. Thank you.

7                   MS. LEWIS: The Chair recognizes Jerry  
8       Jeske.

9                   MR. JESKE: So, the question of novel  
10       keeps coming up and I certainly agree with what  
11       Sebastiaan was just saying. You talk about how  
12       something is novel. I don't think you're ever  
13       going to be able to define what is novel. Just  
14       like it is very, very difficult to define, who are  
15       the constituents, who are those that have some  
16       skin in the game when it comes to a new product.  
17       It's just not exclusive to the FCM community.  
18       It's just not exclusive to large institutions.  
19       Those people that manage risk, whether they're in  
20       agriculture, if they're in energy, if they're in  
21       various different types of products, all have the  
22       potential to be stakeholders. So, it would great

1 if the Commission and exchange staff had endless  
2 time to develop these products and so forth but  
3 they don't. Time does matter. So, to the extent  
4 you're going to engage those that are true  
5 stakeholders, I think it is somewhat of an endless  
6 process.

7           Certainly, I think, one can learn as I  
8 mentioned earlier, from the electricity  
9 marketplace. The RTOs and the ISOs and the  
10 stakeholder process is a very tenuous strained  
11 process. So, what has been done here and  
12 continues to be done, I think, is something to be  
13 embraced, not to be criticized. So, just because  
14 we have something which one may define as novel, I  
15 think I've heard a couple people in this room in  
16 side conversations say, don't throw the baby out  
17 with the bath water. Self-certification is not  
18 broken. So, whether it's novel, whether there are  
19 enough constituents involved in the process, I  
20 think is an endless debate and probably there is  
21 no resolution to that question.

22           MS. LEWIS: The Chair recognizes Marcus

1 Stanley.

2 MR. STANLEY: Thank you. This might have  
3 been a question that was better placed to CFTC  
4 staff in the morning but I'll place it to this  
5 group. The Securities and Exchange Commission has  
6 taken a very different kind of perspective and  
7 approach from the CFTC in terms of its approval or  
8 its perspective toward Bitcoin products. It has  
9 issued quite a number of warnings, it has refused  
10 to approve what could classed as a Bitcoin  
11 derivatives product like exchange traded products,  
12 exchange traded funds. There are several reasons  
13 for that, including, I think, the attitude of  
14 Chair Clayton, the Chair of the SEC as opposed to  
15 the attitude of the governance of the CFTC. Also,  
16 statutory differences and distinctions. One of  
17 those statutory differences is that in the  
18 Exchange Act, there is a requirement that the  
19 rules of an exchange be designed to prevent  
20 fraudulent and manipulative acts in practices and  
21 to protect investors in the public interest. So,  
22 there is kind of a general public interest

1 provision in there. The Commission interpreted  
2 that to say that any exchange traded product had  
3 to have surveillance transparency into the  
4 underlying trading markets. The trading markets  
5 for the underlying had to be regulated.

6 I'm wondering if this group feels that  
7 there is something of value in the public interest  
8 provision for that sort of general public interest  
9 provision as regards exchange rules and whether  
10 the position the SEC took in terms of needing  
11 surveillance into the underlying and having  
12 regulated underlying markets was a reasonable and  
13 positive one.

14 MS. LARSEN: Well, I think there a  
15 couple of things that are different with the SEC  
16 in addition to the language that you mentioned.  
17 The SEC, it's true with the ETF and their reasons  
18 are shifting slightly on that. Initially, it was  
19 that there were no regulated markets and now I  
20 think it goes more to Ed's point that they want  
21 more time for price discovery and more time for  
22 watching the products before. They've asked those

1       that have submitted the ETF request to withdraw  
2       until there is more time to evaluate.

3                   But they have not said that they have  
4       any jurisdiction over Bitcoin or any crypto  
5       currencies. They have likened Bitcoin and crypto  
6       currencies akin to money as opposed to the crypto  
7       assets where a lot of their warning and investor  
8       warnings go to the token sales that are going on.  
9       Right now, they're focused significantly on  
10      potential fraud in those markets.

11                   I think that there are a few different  
12      buckets that the SEC is looking through and the  
13      prism they're viewing this through is just a very  
14      different view from the CFTC and the commodities  
15      world where starting with Coin Flip in 2015,  
16      establishing that crypto currencies are  
17      commodities, fit the definition of the Commodity  
18      Exchange Act. And as this market grows, I would  
19      say that that would still be the perspective that  
20      the crypto tokens and crypto currencies are  
21      commodities and how they trade and how derivatives  
22      products are created off of them is a very

1 different process. I think that with the core  
2 principles that are addressed for the futures  
3 exchanges and the SEFs has extensive protections  
4 within that as they stand.

5 MR. KYLE: I think that as soon as you  
6 start trading a futures contract on some  
7 underlying asset, no matter how little regulation  
8 the underlying asset previously had, you  
9 automatically get a little bit of regulation.  
10 Because the problem of manipulation that might  
11 occur in the futures contract when it does occur,  
12 it is also probably occurring simultaneously in  
13 the underlying. And the CFTC is going to start  
14 inquiring about the underlying and asking  
15 questions and collecting information and imposing  
16 various legal obligations on the exchanges to go  
17 along with the CFTC's learning process. So, part  
18 of undoing the novelty of a novel situation is the  
19 CFTC learning. Part of that learning is  
20 effectively regulation coming into a market that  
21 did not used to be regulated.

22 So, I think the big question here is



1       whether the right way to do it is to be so  
2       cautious getting into it that you wait a long time  
3       and don't start anything until you fully  
4       understand it. Or alternatively, to experiment  
5       with the ideas that may not be very good and  
6       markets that may not work very well. Then if they  
7       fail, so what, maybe they just fail on a very  
8       small scale.

9               I know I've brought up these past  
10       examples but let me bring up another one. I  
11       believe the first interest rate futures contract  
12       was the Jenny May CDR contract from the 1970s. I  
13       believe that was a totally flawed contract. The  
14       idea of futures on mortgages backed securities was  
15       a fabulously good idea. But the contract itself  
16       was terrible. It was, nevertheless approved. It  
17       nevertheless traded for a number of years.  
18       Eventually, the flaws became apparent and there  
19       was a migration out of that one into another one  
20       and then that one maybe didn't work so well either  
21       and eventually the treasury bond futures contract  
22       and now treasury note futures contracts have

1       become the center for determining interest rates  
2       in the U.S. So, it started out with a process  
3       that you might say approved some novel contracts  
4       that didn't work very well, maybe because they  
5       didn't think through it enough. The end result  
6       was, I think, quite good.

7                   The other side of the coin which goes to  
8       Marcus's question about the SEC is single stock  
9       futures. I think single stock futures are a great  
10      idea. It was a great idea in the 1970s when they  
11      were proposed. So, what happened for the next 20  
12      years with respect to single stock futures, the  
13      answer is, not very much. And the reason, I  
14      think, not very much happened is that the SEC  
15      didn't want to do anything unless it was perfect.  
16      Nothing is perfect so nothing got done and that  
17      was kind of a bad outcome. So, something probably  
18      in between is a good idea where there is some  
19      thought that goes into the process of designing a  
20      futures contract but the knowledge that even when  
21      it is first approved, it's not perfect. It is a  
22      learning process that you're getting into is the

1 right way to think about it.

2 MS. LEWIS: We're going to take one more  
3 question. The Chair recognizes Kathleen Cronin.

4 MS. CRONIN: Thank you. There has been  
5 a lot of discussion of novel and complex. I think  
6 what is important to reiterate from our  
7 perspective is that the asset class, the  
8 underlying asset class is a new asset class. But  
9 our product itself is very much in line with other  
10 products that we've done on indexes. A number of  
11 the factors that Mr. Pla mentioned with respect to  
12 what constitutes a novel product, I think,  
13 volatility doesn't make something novel, it is  
14 something to be managed and it feeds into how we  
15 determine what our risk processes are going to be.  
16 Bitcoin futures has our index has a year history  
17 and Bitcoin itself has a much longer price history  
18 than that.

19 In terms of impact on the risk pool,  
20 again, we trade and clear products that are  
21 volatile and that create certain risks outside of  
22 Bitcoin. I think Julie mentioned the emerging

1 currencies which is a good example and we do risk  
2 manage for those and it doesn't present a unique  
3 risk to the mutualized risk pool. Again, we did  
4 have over 200 meetings with customers, clearing  
5 members and others during this process. You're  
6 not going to reach consensus as to what is a good  
7 product to bring to market or not bring to market.  
8 Ultimately, it's up to the exchange to  
9 self-certify those products and ensure that  
10 they're in compliance with the core principles.  
11 And our clearing members can choose to clear those  
12 products or not. Frankly, if no one chooses to  
13 clear the products, then it is not going to be  
14 successful so it is not in our best interest to  
15 bring it forward.

16 MR. ARCHITZEL: Thank you. So, I think  
17 we've had a pretty productive day and a very good  
18 conversation. To wrap up, I'll pose two questions  
19 that I think everybody will have an opportunity to  
20 answer. As we go around the table, just lift your  
21 nametag up if you'd like to respond.

22 The questions are, one what is an

1 optimal process for SRO introduction of new  
2 products and specifically novel products. Number  
3 two, what is an optimal process for CFTC oversight  
4 of new products both pre and post launch.

5 MR. PLA: I'll reiterate what I said  
6 earlier and I think many of us have said as a  
7 disclaimer at the beginning of all the comments.  
8 I think certainly FIA believes that the  
9 self-certification process is valuable. It's  
10 valuable to our markets and it encourages  
11 innovation and has a history of encouraging  
12 innovation. I think the comments made by Chairman  
13 Giancarlo a couple of weeks ago at the ABA  
14 conference, to me, indicates a willingness to say  
15 let's reflect on what we've learned. Is there  
16 something about this particular product and set of  
17 circumstances that wasn't envisioned and is there  
18 an adjustment we should make. I think the  
19 recommendations he's already proposed which is,  
20 DCMs and SEFs should be asked to disclose the  
21 steps they've taken to gather and accommodate  
22 input from concerned parties. Extremely sensible.

1 And make that available so that people understand  
2 how those comments and that feedback is  
3 incorporated into the product design and the  
4 product launch. I don't think that is throwing  
5 the baby out with the bathwater by any means, I  
6 think that is taking a very good and valuable set  
7 of regulations and finding ways to make them even  
8 better and more fit for purpose as we continue to  
9 find new product types that are valid for listing.

10 MS. LEWIS: The Chair recognizes Marnie  
11 Rosenberg.

12 MS. ROSENBERG: Thank you. I thought  
13 Biz asked a really good question on a prior panel  
14 about why has there been so much controversy over  
15 this launch if the exchanges and the clearing  
16 houses on the panel sought input. Clearly, I  
17 think, there is a need for a member consultation  
18 process that happens on the front end which, I can  
19 say, didn't universally happen in this case. And  
20 given that members ultimately do provide a  
21 significant amount of financial resources that is  
22 mutualized, there is a vested interest in the

1 clearing member community from a risk perspective  
2 to be engaged and provide input.

3 We, at JP Morgan invest a lot of  
4 resources and due diligence of margin models and  
5 stress testing. And we do spend a lot of time  
6 giving that feedback back to clearing houses. We  
7 do hope that that is considered in this process  
8 going forward.

9 MS. LEWIS: The Chair recognizes Dale  
10 Michaels.

11 MR. MICHAELS: I think the  
12 recommendation as far as having DCMs prove that  
13 there has been some type of reach out is a valid  
14 path, one that certainly we want to see happen, at  
15 least from the clearing house perspective. We do  
16 have venues to reach out to our clearing member  
17 firms to solicit feedback. Not just the clearing  
18 member first but the buy side constituents as well  
19 that is important to us. I was a little surprised  
20 at the disconnect and I think that's a lesson to  
21 learn. Make sure the right folks from each of the  
22 firms are on the panel so that that feedback is

1 getting back to the proper folks at each of the  
2 firms. These are important feedback forums  
3 because, as I mentioned, we do take this feedback  
4 seriously and this feedback goes to our risk  
5 committee. We want to get that opinion, we want  
6 to know what concerns that are out there, purely  
7 from a risk management perspective.

8 We certainly don't want to get into the  
9 competitive issues. We think that the  
10 self-certification process has led to a great deal  
11 of innovation in this industry. You see the  
12 products that have been launched. The CFTC  
13 oversight has been tremendous. You talk about  
14 Jenny May CDR leading to treasury bonds and the  
15 interest rate futures leading to the energy  
16 futures and everything else. We want to continue  
17 that path but we do need to make sure the risk  
18 management considerations which are very important  
19 to us, very important to our clearing member firms  
20 and the buy side constituents. We take that  
21 seriously and want to make sure that happens as  
22 well.



1                   MS. LEWIS: The Chair recognizes  
2 Kathleen Cronin.

3                   MS. CRONIN: I'll be short because I  
4 think I have reiterated my views before. I think  
5 the self-certification process as it currently  
6 exists, works well. I think we had a robust  
7 dialogue with Commission staff before we launched  
8 this product as well as with customers. We took  
9 into account, feedback in making our decisions as  
10 to how to design the product. We continue to  
11 remain open to feedback from our clearing members  
12 with respect to how we are risk managing the  
13 process. I think none of our clearing members are  
14 shy about providing us with feedback and so we are  
15 happy to engage in discussions on that.

16                  MR. PLA: One point I would make on the  
17 notion of risk committees. I think that's a valid  
18 group of people to consult. I'm not sure that's a  
19 comprehensive group of people to consult. Their  
20 composition could be distinct. They're not  
21 necessarily a representative sample of all  
22 constituents including trading firms and clearing

1 firms. I think that's a necessary but not a  
2 sufficient condition. If we decide that a product  
3 is sufficiently novel, that that kind of market  
4 outreach is a desirable component in the process.

5 MS. LEWIS: The Chair recognizes Marcus  
6 Stanley.

7 MR. STANLEY: I think from a public  
8 interest perspective, we always get concerned when  
9 clearing members publically raise an issue about  
10 risk management at the clearing houses that they  
11 are members of. It is hard to see what the  
12 incentive would be to do that if there is not  
13 actually a problem. So, even though we don't  
14 always agree with clearing members on all their  
15 positions, on this one in particular, raising an  
16 issue about risk management, we consider that a  
17 red flag. The fact that it has come up in this  
18 case, I think does point to issues for concern in  
19 self-certification.

20 MS. LEWIS: The Chair recognizes Richard  
21 Miller.

22 MR. MILLER: To your second question,

1 Paul, about how the CFTC surveils or risk manages  
2 on an ongoing basis, I had a thought that came to  
3 mind when I was reading Professor Kyle's resume.  
4 We have something in common that goes back to the  
5 1987 crash. At that time, the poster child of the  
6 1987 crash were stock index futures because of the  
7 product that was popularized in the financial  
8 markets called portfolio insurance. And portfolio  
9 insurance assumed that you'd be able to execute  
10 stock index futures into a declining market. And  
11 it was sold as a risk management tool to financial  
12 end users.

13 But the overhang of the potential user  
14 portfolio insurance, would not have been reflected  
15 in open interest and would not have been reflected  
16 in the markets but was a product that was hanging  
17 outside the markets. You wouldn't have been able  
18 to see that in the futures markets until it  
19 actually happened. So, the cautionary tale you  
20 take away from that is that ongoing surveillance  
21 of the marketplace has to take into account not  
22 just what you see in the marketplace but sort of

1 the anecdotal evidence of what is out there, that  
2 is being packaged up in financial products that  
3 might be sold on an ongoing basis, popularized.  
4 It seems to me just intuitively that the mystery  
5 around Bitcoin has the same kind of magical charm  
6 that portfolio insurance had and stock index  
7 futures had back in the 1980s. It might become an  
8 attractive financial product to be packaged up and  
9 you might not, as a means of hedging somehow, that  
10 you may not see as product in the market because  
11 it is an overhang. So, my cautionary remark is,  
12 the CFTC needs to be aware of what's out there  
13 that may not be reflected actually in the open  
14 interest and what is actually in the clearing  
15 markets at the time.

16 MS. LEWIS: The Chair recognizes  
17 Biswarup Chatterjee.

18 MR. CHATTERJEE: As per the discussions  
19 going on, I think the comment from Jerry was very  
20 valid. We shouldn't try to change the  
21 self-certification process by labeling products  
22 good or bad or novel or plain whatever. In the

1 end, the entire robustness of the  
2 self-certification process relies on transparency.  
3 And whether that is transparency between the  
4 exchanges listing the product with their trading  
5 partners, with the clearing houses that are going  
6 to clear it, with their FCMs, or the clients that  
7 would be indirectly clearing it and sharing their  
8 transparency with the Commission. I think that's  
9 where the robustness of the self-certification  
10 process really falls.

11 A number of points have been made, I  
12 think Dale just touched on it, making sure if you  
13 are consulting people, it is the appropriate  
14 constituency you are consulting. One of the  
15 panelists mentioned in the previous panel, the  
16 challenges of reaching out to a firm and then  
17 making sure you're getting a consistent view. The  
18 trading arm versus the clearing arm versus the  
19 operational arm may give you different views. I  
20 think, Rana, I think you alluded to the point that  
21 the broad FCMs and their readiness to clear should  
22 also be a key factor into whether the product will

1 face a much more smoother transition. It is a  
2 variety of these things and I don't think we  
3 should just be limiting this activity to novel  
4 products.

5 MS. LEWIS: We have one more.

6 MR. MACKEY: Just one quick comment.  
7 From an end user's perspective, if the banks do  
8 have concerns with the process as far as  
9 self-certification and the product, they have the  
10 ability to charge their customers additional  
11 margin or limit positions as well. That is from a  
12 risk management standpoint which we see as an end  
13 user. In particular where there are potentially  
14 products that at different parts of the bank may  
15 be competing on a bilateral basis, I'd caution  
16 that to some extent, where there is market  
17 participation for clearing it makes sense to have  
18 some discussion around the risk management aspect.  
19 But the commercial aspects of it, as Jerry pointed  
20 out, are really specific and where end users are  
21 actually looking for unique products to  
22 potentially hedge risks that they can't lay off in

1 traditional ways through some of the financial  
2 institutions and other market participants that  
3 warehouse the risk on behalf of the end users.  
4 Thank you.

5 MS. LEWIS: Thank you, Paul, for  
6 moderating today's panels. It is now time for  
7 closing remarks. We'll start with Commissioner  
8 Quintenz.

9 COMMISSIONER QUINTENZ: Thank you very  
10 much, Alicia. Thank you for all of your hard work  
11 for today's hearing. Commissioner Benham, thank  
12 you for your leadership of this group. Paul,  
13 thank you for your steady hand in guiding the  
14 conversation and members of the Advisory  
15 Committee, thank you all for your feedback. I  
16 learned a lot from each of your comments and  
17 questions. To all of the presenters, thank you  
18 for the work that you have put in to bringing  
19 really interesting thoughts to us, to the staff.

20 I wanted to bring up something that  
21 Commissioner Benham raised in his opening comments  
22 which is that novelty is a fleeting concept. I

1 think it goes back to what you said as novelty as  
2 a continuum. We're seeing in the market now,  
3 we're seeing digital commodities being created on  
4 a daily basis. So novelty, to some extent is  
5 actually becoming somewhat mundane. While it may  
6 be tempting for all of us to want to draw bright  
7 lines and create tests around that, I think it is  
8 also important to remember how well this agency  
9 has been served and how well the markets have been  
10 served through a principles based regulation.

11           Lastly, I wanted to complement the  
12 Agency staff, not only those that gave very robust  
13 presentations today, but also all of our staff  
14 that work hard on a daily basis to make sure that  
15 market participants are following the CEA and our  
16 Commission regulations. Thank you all for  
17 participating today. I really appreciate it.

18           MS. LEWIS: Thank you, Commissioner  
19 Quintenz. Commissioner Benham.

20           COMMISSIONER BENHAM: Thank you, Alicia.  
21 I want to echo Commissioner Quintenz's comment  
22 about CFTC staff. They do a fantastic job day in



1 and day out and I think we have the commission of  
2 them pretty much everything that comes out of this  
3 building. It is really fantastic work. Of  
4 course, for those staff involved today on the  
5 first two panels, thank you again for your work  
6 and your contributions. A lot to be taken away  
7 from today. I appreciate everyone's time and  
8 effort. A lot of different conversations from  
9 different angles. Obviously, self-certification  
10 is a big issue and one that is the headliner of  
11 the discussion.

12 For me personally, as I said in my  
13 opening comments, self-certification is over 15  
14 years old. It has worked well, it continues to  
15 work well and I think it will work well in the  
16 future. It serves the market well, it serves the  
17 CFTC well and it promotes innovation which, I  
18 think, should be our number one priority. So, I  
19 hope that message is clear and we'll continue to  
20 support the self-certification process. That  
21 said, there is always room for improvement and I  
22 think from both sides, the market participant

1 side, clearly the processes that are in place when  
2 new products are launched are very well  
3 established. I think everyone clearly  
4 demonstrated that. Processes are in place and  
5 people are constantly thinking about these. I've  
6 said this many times, the incentives certainly  
7 with the market participants to put out good  
8 products that last and that have utility in the  
9 marketplace for both the exchanges, the clearing  
10 members and, of course, the end users.

11 From the CFTC side, the first two  
12 panels, I think, the individuals demonstrated what  
13 the Commission does every day to ensure that we  
14 are fulfilling our responsibilities both under the  
15 core principles but the act and the regulations as  
16 well. I applaud them for all the work and I think  
17 the processes there are as well very good. That  
18 said, regardless of this question about novel or  
19 not, we constantly need to be thinking about new  
20 products that are coming to market. As they do  
21 come to market, forums like this, I personally  
22 feel a lot better this afternoon than I did this

1 morning let alone a week ago or a month or two  
2 ago. That's because we're able to have this very  
3 transparent and honest conversation about what has  
4 been going on with respect to cryptos and how it  
5 affects the marketplace.

6 I hope we can continue to do this  
7 because I think this is going to make all of us at  
8 this table, the regulators, the market  
9 participants and the general public, feel pretty  
10 good about what we do on a daily basis. That  
11 said, like I said earlier, there is always room  
12 for improvement and I think these venues serve as  
13 an opportunity to think about hard questions and  
14 better solutions in the future.

15 With that, a quick thanks to Paul  
16 Architzel for your time. Paul was a great  
17 moderator and a gentleman who has a lot of history  
18 in this building and understands these issues very  
19 well. Alicia, thank you again for really doing a  
20 fantastic job for the past two months. I know  
21 you're looking forward to future MRAC meetings,  
22 not soon. Thanks to Commissioner Quintenz for

1 participating all day and adding very insightful  
2 thoughts and comments as always. And, of course,  
3 to the Chairman for attending while he could.  
4 Finally, to this Committee as I said earlier, this  
5 will likely be the last meeting of the Committee.  
6 Alicia will be taking steps in the next couple of  
7 weeks or months to issue a very broad invitation  
8 to the general public for the next MRAC. We  
9 welcome your participation or at least your  
10 interest to participate in the future. That said,  
11 we'll be taking a fresh look and thinking about  
12 ideas and issues to cover in 2018/2019 and the  
13 years ahead. Thanks, I know Commissioner Bowen  
14 was very proud of this Committee and the work it  
15 did and you all deserve a big thanks for your  
16 sacrifice and the time you've given to it. Thank  
17 you, and with that, I'll turn it over to Alicia to  
18 wrap up.

19 MS. LEWIS: Thank you, Commissioner  
20 Benham. Again, thanks to the members of the MRAC  
21 for a very engaging discussion today. Thank you  
22 to our speakers for great presentations. I want

1 to thank everyone for attending the first MRAC of  
2 2018. This meeting is adjourned.

3 (Whereupon, at 3:53 p.m., the  
4 PROCEEDINGS were adjourned.)

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I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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