1 U.S. COMMODITY FUTURES TRADING COMMISSION (CFTC)

2

3 GLOBAL MARKETS ADVISORY COMMITTEE (GMAC)

4

5 Tuesday, September 24, 2019

6 9:33 a.m.

7

8 Commodity Futures Trading Commission - CFTC

9 Three Lafayette Centre

10 1155 21st Street, N.W.

11 Washington, D.C. 20581

12

13

14 BEFORE:

15 Dawn DeBerry Stump, GMAC Sponsor and

16 Commissioner, CFTC

17 Angie Karna, Chairperson

18 ALSO PRESENT:

19 Heath P. Tarbert, Chairman, CFTC

20 Brian D. Quintenz, Commissioner, CFTC

21 Rostin Behnam, Commissioner, CFTC

22 Dan M. Berkovitz, Commissioner, CFTC

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

2 MS. GOLDSMITH: Good morning. Welcome to the
3 Global Markets Advisory Committee meeting. As the
4 Designated Federal Officer, it is my pleasure to call
5 this meeting to order. We are very much looking
6 forward to today's presentations and discussions. I
7 just want to go through a couple logistical items
8 before we start.

9 Please ensure that your microphone is on
10 before you speak, and that is done just by simply
11 pressing the button. When you speak, please speak
12 clearly into the microphone. This will allow both the
13 webcast audience and those participating by phone to
14 hear you.

15 In addition, if you would like to be
16 recognized during this, the discussion, please change
17 the position of your name tent so that it sits
18 vertically on the table in front of you. The chair of
19 the meeting will recognize you and give you the floor.

20 I would like to turn it over now to the GMAC
21 sponsor, Commissioner Stump, who will give her opening
22 remarks.

23 COMMISSIONER STUMP: Thank you, Andrée.

1 Good morning. Welcome to our second GMAC
2 meeting of 2019. I want to begin by welcoming Chairman
3 Tarbert. It is quite appropriate given his background
4 in international matters, that his first advisory
5 committee meeting as chairman of the CFTC has a global
6 focus. And we are thrilled that he is here, very
7 fortunate to have his expertise here at the CFTC.
8 I also want to thank Commissioners Quintenz
9 and Behnam for being here today as well as Commissioner
10 Berkovitz for his engagement via webcast. I know that
11 your contribution to the discussion will be appreciated
12 by all of the participants.
13 I also want to thank all of the members of
14 GMAC for making an effort to be here, both in person
15 and on the telephone, and to the panelists for all of
16 their efforts in putting together the presentations. I
17 know it is no small task, and we are very appreciative
18 for your participation.
19 And, lastly, I want to thank the Designated
20 Federal Officer for GMAC, Andrée Goldsmith, for all of
21 her efforts and her energy and her attention to all of
22 the details for this meeting. It is greatly
23 appreciated.

1 At the GMAC meeting in April, we covered a
2 wide variety of issues that made up the key pillars of
3 the 2009 Group of 20 Leaders' directive regarding the
4 OTC derivatives markets. My goal today is to use that
5 discussion as a jumping-off point for today's agenda.
6 Specifically, today's presentations will delve deeper
7 into two specific topics that we touched on in April:
8 one, the global process applied to implementing initial
9 margin for non-centrally cleared derivatives and how
10 the phasing of such has progressed; and how clearing
11 through central counterparties has evolved since the
12 crisis. Regarding clearing, we will specifically
13 discuss European legislation known as EMIR 2.2 as it
14 relates to non-E.U.-based central counterparties,
15 including those under CFTC registration. Regarding the
16 exchange of initial margin for non-centrally cleared
17 derivatives, now is a good time to step back and
18 reflect on the past implementation phases and to
19 explore in more detail the issues faced by market
20 participants who have or will in a future phase become
21 subject to the requirements. This exercise is
22 important in my view in order to understand whether
23 there are actions that we as regulators can take to

1 mitigate the potential compliance bottleneck caused by
2 an unprecedented number of market participants coming
3 into scope in the last implementation phases.
4 First, we will hear an update from the
5 regulators. Mike Gibson from the Division of
6 Supervision and Regulation at the Board of Governors of
7 the Federal Reserve System will talk about actions
8 regulators have taken with respect to the margin rules.
9 In a timely development, several regulators voted on a
10 joint notice of proposed rulemaking last week that
11 would amend certain aspects of their swap margin rule.
12 Mike will update us on those amendments. And then
13 Rafael Martinez will update the group on the CFTC's
14 recent actions, including a staff advisory issued in
15 July in support of the BCBS-IOSCO statement from
16 earlier in the year, which clarified that documentation
17 requirements for uncleared swaps would not apply until
18 a firm exceeds the $50 million IM threshold with a
19 particular swap dealer.
20 Next we will hear from buy-side market
21 participants. Richard Grant from AQR Capital
22 Management and Wendy Yun from Goldman Sachs Asset
23 Management will discuss some of the challenges and the

1 preparations their firms have undertaken to prepare for
2 the upcoming implementation phases. Among the issues
3 Richard and Wendy will touch on are those involving
4 separately managed accounts, seeded investment funds,
5 eligible collateral, and documentation.
6 The third panel on uncleared margin will
7 feature Dominick Falco from BNY Mellon and Judson Baker
8 from Northern Trust. The two panelists represent
9 custodian banks tasked with holding initial margin for
10 non-centrally cleared derivatives. They will discuss
11 their experience engaging with market participants in
12 the earlier phases of implementation and what they are
13 doing to prepare for the unique challenges of later
14 implementation phases. The custodian's perspective is
15 one that we don't often hear here at the CFTC, and I am
16 looking forward to learning more from Dominick and
17 Judson on how they are managing the documentation and
18 operational challenges.
19 Lastly, Tara Kruse from ISDA will present on
20 some of the differences across jurisdictions that have
21 evolved relative to regulatory implementation of
22 uncleared margin rules. Jurisdictional differences in
23 key areas, such as settlement timeframes and eligible

1 collateral, present challenges for market participants.
2 After lunch, we will turn our focus to the
3 cleared derivatives space and how regulation of global
4 central counterparties has evolved. Specifically, Sean
5 Downey from the CME Group, Carolyn Van den Daelen from
6 ICE Clear Europe and Jackie Mesa from the FIA will
7 present on the provisions of EMIR 2.2 that affect non-
8 E.U.-based CCPs and ESMA’s related draft technical
9 advice and consultation reports. EMIR 2.2 materially
10 changes the regulatory framework for non-E.U.-based
11 CCPs, particularly when those CCPs are determined to be
12 systemically important to the E.U. or one of its member
13 states. I believe that it is important that we fully
14 understand the proposed changes and how they might
15 affect our own registered derivatives clearing
16 organizations. Sean, Carolyn, and Jackie will present
17 on the specifics of ESMA’s consultation papers in
18 tiering criteria and on comparable compliance,
19 including their reactions to the ESMA’s proposals.
20 I am looking forward to digging deeper into
21 some of the topics we covered more generally in the
22 April meeting. And I again want to recognize the
23 tremendous amount of work and time that has gone into

1 preparing for this meeting. Thank you, Andrée.

2 MS. GOLDSMITH: Chairman Tarbert?

3 CFTC CHAIRMAN TARBERT: Well, thank you very

4 much, Commissioner Stump, for convening this meeting.

5 Thank you to all of you for being here. I see many

6 faces that I have known throughout my time here at the

7 CFTC, all 60-plus days, as well as in my various former

8 roles at the U.S. Treasury and even in the private

9 sector prior to that. So it is great to have you all.

10 Andrée, thank you so much for your work in making this

11 possible.

12 We have got two big-ticket items today.

13 Right? We have got margin requirements and the phase-

14 in of phase 5. And this is really important because we

15 are literally going from about 40 covered entities to

16 over 700. And in that 700, we expect that we could see

17 the operationalizing of about 7,000 initial margin

18 relationships when we move to phase 5. So I think it

19 is really important that we take the time to get it

20 right, we understand the insights from our fellow

21 regulators at the Fed as well as from all of you that

22 are affected. I will note that the banking regulators

23 on September 17th extended the compliance period for

1 one year. I can tell everybody today that our staff
2 has been working on a proposal to amend the
3 corresponding deadline for our rules. And it is my
4 hope that the Commission will vote in the near future
5 on whether to issue the proposal.
6 Other big-ticket item obviously is EMIR 2.2.
7 And I know this advisory committee has spoken to this
8 issue in the past. And your views have been really
9 important in helping us understand the issue better and
10 working on the dialogue with our European counterparts.
11 Obviously, CCPs are really important. Many of them are
12 systemically important. And we fully understand that
13 every financial system has to think about systemic risk
14 that it faces, whether that risk comes from inside the
15 system or potentially outside the system. I think our
16 view is that at present, none of our CCPs in the United
17 States, based in the United States, pose systemic risk
18 outside the United States and certainly not to Europe.
19 But, nonetheless, we understand the reasons why EMIR
20 2.2 has been brought to the fore to deal primarily with
21 the Brexit situation. And what we want to do is make
22 sure that we don't end up in a place where we have, you
23 know, again by inadvertent regulatory moves, market

1 fragmentation, contradictory rules, and even
2 potentially increases to systemic risk here in the
3 United States.
4 So to that end, we have started the dialogue
5 with the European Commission under my chairmanship as
6 well as ESMA. We have had one very good meeting where
7 we had the opportunity to talk more about deference to
8 really truly understand their concerns. And so we are
9 hopeful that over time, we will be able to address any
10 concerns they have while also reaffirming the concerns
11 that we have in getting to a place where we have got
12 global cooperation. So we very much look forward to
13 your views in that regard, ways that we can continue on
14 that path to reach a mutually beneficial solution.
15 Thank you.
16 MS. GOLDSMITH: Commissioner Quintenz?
17 COMMISSIONER QUINTENZ: Thank you very much.
18 And thank you, Commissioner Stump, for your leadership
19 of the GMAC and for the important agenda today. Thank
20 you, Andrée, for your hard work. And thank you, Angie,
21 for your leadership as well.
22 Let me just quickly echo the comments of both
23 Commissioner Stump and Chairman Tarbert. These are two

1 very important issues. I think it makes a lot of sense
2 to continue to discuss them publicly. The uncleared
3 margin rules I think show the problems with using
4 notional value. They show the problems when
5 regulations are not calibrated to the risk and when
6 cost-benefit analysis is inadequate.
7 Hopefully we will continue to move away from
8 using notional value in regulatory rules that impose
9 costs without relation to risk because I think we have
10 been dealing with the negative impacts of those
11 decisions for quite some time now. And I am very
12 pleased that we are taking action to try to resolve
13 some of them, but I think it is important that we also
14 acknowledge that this should be the end of that type of
15 consideration.
16 I am very grateful to the chairman, his
17 leadership, and look forward to considering any action
18 that the Commission can take to alleviate the burden
19 and to provide more compliance time or to recalibrate
20 those rules.
21 On EMIR 2.2, let me just say that I think we
22 are all well-aware of the tiering proposals. And I
23 think it is important to acknowledge that this is not

1 an exercise in big data analytics, where thousands or
2 millions of data points are run through some type of
3 tiering or sorting algorithm to arrive at an unknown
4 result. I believe it is impossible to develop this
5 proposal and to calibrate this framework without
6 knowing the results. Therefore, I think the earlier
7 that we all receive clarity on what those results are,
8 the more likely it is we can avoid very negative
9 consequences and outcomes that have yet to be taken off
10 the table.
11 So let me commend again the GMAC for
12 addressing these very important issues. I look forward
13 to hearing all of your thoughts. Thank you.
14 MS. GOLDSMITH: Commissioner Behnam?
15 COMMISSIONER BEHNAM: Good morning. Welcome,
16 everyone. Good to see all of you. First off, thanks
17 to Commissioner Stump, Andrée, and Angie, of course,
18 for your leadership and Chairman and Commissioner
19 Quintenz.
20 I will just reiterate what everyone said
21 already, very important issues, look forward to hearing
22 from everyone. And I do appreciate and acknowledge
23 both Chairman Tarbert and Commissioner Stump's

1 leadership on these very important issues, a lot of
2 very difficult questions to sort of unpack that have a
3 lot of big consequences, so look forward to the
4 committee’s deliberation and any recommendations and
5 Commission action. Thank you.
6 MS. GOLDSMITH: And I will turn it over to
7 Angie to get the agenda started.
8 CHAIRPERSON KARNA: Great. Thank you very
9 much, Chairman, Commissioner Stump, Andrée, and the
10 other commissioners. And thank you all for
11 participating here today.
12 As you have heard, we have a very busy day.
13 We are going to be digging into two very important
14 issues. Your diverse perspectives are very welcome.
15 And, as a logistic matter, just to remind you, after
16 each panel presentation, there will be an opportunity
17 for questions, comments, and other feedback. If you
18 just put your card vertically, then I will know to call
19 on you.
20 So, to start off, we are going to have our
21 first panelist, Michael Gibson, who is the director of
22 the Division of Supervision and Regulation for the
23 Board of Governors of the Federal Reserve; and Rafael

1 Martinez, who is a senior financial risk analyst for
2 the Division of Swap Dealer and Intermediary Oversight
3 at the CFTC. And they are going to be providing a
4 status update on the implementation of uncleared margin
5 rules.
6 MR. GIBSON: Thanks for the opportunity to
7 join your group today. I am Mike Gibson. I am from
8 the Federal Reserve Board here in Washington, from bank
9 supervision, but, more importantly for this group, I am
10 also one of the two co-chairs of the international
11 working group on margin requirements that has developed
12 the uncleared margin standards that we are talking
13 about today and has been monitoring their
14 implementation over the past few years. It is a joint
15 working group that is cosponsored by the Basel
16 Committee on Banking Supervision and the International
17 Organization of Securities Commissioners, IOSCO. So we
18 have a broad representation on the group and I am happy
19 to talk about some of the progress that has been made
20 over the past few years.
21 Just to set the landscape, I would just
22 remind everyone that as part of the post-financial
23 crisis reform efforts under the auspices of the G20,

1 there was an effort to improve the safety and security
2 of derivatives markets. And probably the most
3 important part of that effort was a shift of
4 standardized derivatives into clearing. So, obviously,
5 the CFTC has played a big part in that here in the U.S.
6 Another part of the G20 program on
7 derivatives markets was to have margin requirements on
8 uncleared derivatives. There were two basic reasons
9 for that. The first was to make sure that the program
10 to move standardized derivatives into clearinghouses,
11 that the incentives were right. So if uncleared
12 derivatives had much lower requirements, there might be
13 an incentive to avoid clearing. And nobody wanted to
14 see that happen given the benefits of clearing for
15 financial stability. And then just generally
16 recognizing that not all derivatives can be cleared,
17 there was a recognition that uncleared derivatives
18 needed the safety and security that margin requirements
19 provide to reduce the overall systemic risk in the
20 system and the interconnectedness from derivatives
21 markets.
22 So, with those two objectives in mind, the
23 international standards on uncleared margin were

1 developed and have been implemented over the past few
2 years. As has already been mentioned, we are coming up
3 on phase 5 of the implementation. Phases 1, 2, 3, and
4 4 mostly involved larger firms, and phase 5 is when
5 some of the smaller entities are going to come in scope
6 for the margin requirements. Just to remind everyone
7 what these requirements are, the requirements are that
8 for uncleared derivatives, there is an expectation that
9 variation margin should be exchanged and for entities
10 that are above a threshold measured by exposure, that
11 there would be an expectation that initial margin would
12 be held as well. So the initial margin exposure
13 threshold in the international standards is $50 million
14 of exposure. So when we eventually finish with the
15 implementation of these standards, there will be an
16 expectation that entities with greater than $50 million
17 of exposure, that there would be initial margin
18 associated with those relationships.
19 Of course, it is important to note for the
20 scope of coverage of these requirements that it only
21 applies to financial entities. So commercial end-users
22 are not scoped into these requirements.
23 The phase 5 that has already been mentioned

1 is the final, what had been the final, phase of
2 implementation. And the implementation had been
3 staggered based on notional amounts of derivatives that
4 counterparties held. So the first phase, second phase,
5 third phase, fourth phase, there were cutoffs based on
6 notional amounts of derivatives. And this fifth phase
7 would be bringing in, as was already mentioned,
8 hundreds of small financial end-users.
9 The international working group that I
10 mentioned has been doing monitoring of progress on
11 implementation. And last year, we had already started
12 to hear from the industry counterparts about the
13 challenges of bringing on board so many smaller
14 entities in a relatively short period of time. I guess
15 some people would say two years is a lot of time, but
16 for all of the requirements and the number of entities
17 involved, two years is not that much time to do this
18 onboarding.
19 So a couple of things happened at the
20 international level earlier this year to relieve the
21 burden on the phase 5 implementation. The first is
22 that the Basel Committee and IOSCO put out a statement
23 earlier this year clarifying that for counterparties

1 that are below the $50 million exposure threshold, that
2 they would not have to have all of the trading
3 documentations and custody arrangements that would be
4 needed to post and secure initial margin until they are
5 actually crossing the threshold, so the smaller
6 entities. It was clarified that they would not need to
7 have the trading documentation and custody arrangements
8 in place until they actually crossed the threshold and
9 fall in scope. And in that case, then, of course, they
10 would be expected to have the arrangements in place.
11 So that was the first effort out of the international
12 working group earlier this year.
13 The second thing that the Basel Committee and
14 IOSCO did earlier this year was to extend the phase-in
15 period by one year, as was already mentioned in the
16 introduction. So there is an additional phase. I
17 guess it should be called phase 6, which will extend
18 through September 2021 for the smaller financial end-
19 users. Basically, it is splitting up the entities that
20 would have come into scope in 2020 and split them up
21 into 2 groups. So some will come in 2020. Some will
22 come in 2021.
23 The U.S. Prudential Regulators are part of

1 those discussions. And we supported those
2 international changes. And, again, as has been already
3 mentioned, the Prudential Regulators have developed a
4 notice of proposed rulemaking that the FDIC acted on at
5 their board meeting. So the notice of proposed
6 rulemaking from the FDIC is out in the public domain,
7 and you can read it on their website. The Federal
8 Reserve Board has not acted yet. So I can’t speak for
9 what the Federal Reserve Board would be voting on, but
10 we are part of the Prudential Regulator group. So I
11 will just give you a description, a brief description,
12 of what the Prudential Regulators’ notice of proposed
13 rulemaking has. And, again, this is based on what the
14 FDIC has already put out into the public domain.
15 So the first two elements of the notice of
16 proposed rulemaking from the Prudential Regulators are
17 the two things that I already mentioned that came out
18 of the international working group earlier this year,
19 namely the clarification on documentation not being
20 needed for the small entities below the exposure
21 threshold and the additional phase-in into 2021.
22 There are three other elements that I would
23 just briefly mention as part of the notice of proposed

1 rulemaking. Two of these have to do with legacy swaps,
2 and I just have to explain a little bit. Legacy swaps
3 are those that were in place before these margin
4 requirements came into effect. And the margin
5 requirements are only applied to new trades. So
6 existing trades aren't in scope for the requirements.
7 And, of course, a lot of derivates trades are long
8 dated, so there is an expectation that some of these
9 legacy trades could last for a while.
10 The two clarifications that are part of the
11 notice of proposed rulemaking, the first is that these
12 legacy swaps can be amended to replace LIBOR and other
13 similar interest rate benchmarks that, as everyone
14 knows, are being phased out and may disappear in a
15 couple of years. Those contracts need to be amended,
16 and the notice of proposed rulemaking proposes that
17 swaps can be amended to replace LIBOR without losing
18 their legacy swap status.
19 And the second element related to legacy
20 swaps is to clarify that so-called lifecycle events,
21 like trade compressions, would also not cause a legacy
22 swap to lose its legacy status.
23 The final element of the Prudential

1 Regulators' NPR that the FDIC released last week would
2 be to remove the requirement in our rule that initial
3 margin be collected from affiliates, although it would
4 retain variation margin requirements for affiliates.
5 This is consistent with the international standard,
6 and, of course, there are other restrictions on
7 affiliate transactions within bank holding companies I
8 won't go into, but the inter-affiliate margin
9 requirements that had been in the Prudential
10 Regulators' rule were in addition to the existing
11 requirements on bank holding companies, which would
12 stay in place.
13 So I will stop there. And I look forward to
14 answering your questions.
15 CHAIRPERSON KARNA: Mr. Martinez?
16 MR. MARTINEZ: Good morning. So I have been
17 asked to provide the update on the implementation. And
18 a lot of the updates actually coincide with actions
19 taken by the Prudential Regulators. We may have
20 sometimes a difference in terms of the ways we go about
21 it. So we also have interim final rules, orders, no-
22 action letters, and different ways. But, in general,
23 the objective is to remain harmonized with them. And I

1 think we have done quite a decent job of that. We have
2 very frequent calls every week. And we have also not
3 as frequent but with the other regulators around the
4 world that are implementing these rules.
5 And so let me mention much of it is similar
6 to or the same as what Mike had just described to you.
7 I will mention some specifics of where the CFTC stands
8 on that. With respect to the legacy status, so one big
9 concern was that the rules apply prospectively, so for
10 new swaps. Old swaps were exempt from the rule. But,
11 then, in the U.S., any amendment to the swaps would
12 bring in scope those swaps as they were amended. And
13 we have discovered that, actually, there are specific
14 situations in which it actually works contrary to what
15 the intent of the rule is, which is to reduce the risk
16 in the system.
17 So Mike mentioned about there is one
18 situation very clear to everybody is the situation with
19 Brexit in which it is clear that for no particular
20 business decision of a lot of companies in Europe, they
21 will have potentially to change the counterparty of
22 some swaps to be able to service the clients. And so
23 we want those swaps to be amended. And we don't want

1 the margin requirements to be an impediment to that.
2 So we had an interim final rule at the CFTC in March
3 2019 to say that swaps that are transferred legally
4 solely as the result of a no-deal Brexit -- it just was
5 the case for a no-deal Brexit -- that any amendments
6 that have to be made would not bring those swaps, those
7 legacy swaps, into scope.
8 For LIBOR transition, as Mike mentioned, it
9 is part of the prudential rule. CFTC staff, we need to
10 harmonize with the Prudential Regulators, but we also
11 have to coordinate with other divisions because for us,
12 in the CFTC, LIBOR is not just a question of margin,
13 but it also touches on legacy status for clearing, for
14 customer protection, reporting, and several other
15 rules. So we have to find this way of harmonizing both
16 across divisions and with all the regulators. And so
17 we are a bit of second movers on that, but we are
18 actively preparing policy for this right now. And we
19 expect to have something for review by the Commission
20 in the very near future.
21 I should mention at CFTC, we are having very
22 frequent meetings with the ARRC and the Alternative
23 Reference Rates Committee to make sure that we have

1 dialogue so that the relief that we offer is one that
2 actually will be effective.
3 Next, also in May of 2019, the Division of
4 Swap Dealer and Intermediary Oversight issued a no-
5 action letter that provides relief to certain
6 amendments to legacy swaps so that they don't lose
7 their legacy status. They are all amendments that
8 reduce the risk in the portfolios and so the material
9 amendments, partial termination and novations, swaps
10 that result from multilateral compression. So all of
11 these are actions that reduce the risk in the
12 portfolio. And we had the request for that for some
13 time. And Tara knows exactly how long. It is in the
14 months. But I think what really made this something we
15 really needed to do was that it works with the LIBOR
16 and the Brexit case because before amendments need to
17 be made for Brexit or LIBOR, it is ideal that parties
18 can compress and reduce the number of swaps that will
19 have to be amended. So we are hoping that -- and so
20 that is what really triggered issuing this in March.
21 So it should be seen as part of the effort to
22 facilitate LIBOR and Brexit.
23 On issues related to 2020, to the phase-in

1 and the congestion that had been identified, so the
2 CFTC issued, as mentioned by Commissioner Stump, in
3 July an advisory codifying the guidance from the BCBS
4 and IOSCO. So I guess since margin, initial margin, is
5 only exchanged when the exposure is above a $50 million
6 threshold. I think what we have tried to say is if you
7 collect it, you protect it. But you don't need to
8 protect something you have not been collecting. And
9 the protection requires a lot of paperwork and was
10 cited as one of the biggest burdens on the industry for
11 entities that may never exchange margin.
12 Now, that $50 million threshold -- to
13 Commissioner Quintenz's concern about the use of
14 notional. And there is no doubt that notional is a
15 very blunt measure of activity. This serves as a
16 second step if the first step was a calculation of
17 notional, which, by the way, we have a lot of people
18 tell us they are having difficulty calculating
19 notionals to decide if they are in scope or not. But
20 then the second step helps to figure out which ones
21 have the relationship that really needs to be margined
22 by having that risk-based measure. It is not ideal,
23 but it helps that after the notional decision of a

1 minimum swaps activity to be in scope, we have this
2 risk-based measure.
3 Also, they are facing extension. So, as the
4 Chairman mentioned in his opening remarks, we have
5 drafted, DSIO has drafted, a proposed rule to put in
6 place this extension that some Prudential Regulators
7 proposed last week and at the recommendation of BCBS
8 and IOSCO. So we prepared that. And that should be
9 soon circulating for your consideration.
10 Models for phase 5. One of the things, of
11 the concerns, that has repeatedly come up is that
12 developing models is a challenge for many of the phase
13 5 dealers. In addition to preapproval, the
14 requirements to ensure that the model is performing
15 adequately to continue monitoring of the model requires
16 governance, extensive governance, efforts by the firms,
17 such as periodic back testing, benchmarking, and
18 external audits. And some have indicated they may use
19 the simpler method of the GRID, but that, as we know,
20 tends to impose some higher margin requirements than
21 the model. So there are other people who have
22 expressed interest in using a third-party vendor for
23 that. However, that brings the issue of the monitoring

1 and all of the governance. Whether it is a calculation
2 that is done in-house or by a third party, the firm has
3 to retain responsibility to make sure that that model
4 produces numbers that protect the firm.
5 At this point, I want to mention that the
6 National Futures Association, the NFA, with whom we
7 have a lot of coordination -- we have also weekly
8 calls, I think biweekly now but sometimes weekly as
9 needed. They have been very active, reaching out to
10 phase 5 dealers. In the U.S., the model requirements
11 only go to the dealers, not to all of the parties that
12 have to exchange margin. So that is a difference we
13 have with rules in other places. This has allowed us
14 to concentrate specifically on the dealers. And the
15 NFA has been very active, has spoken with every dealer,
16 has asked them about their plans, has tried to respond
17 to all of their questions, and they have had webinars,
18 several of them. And they have generally tried to
19 facilitate the process. So I want to thank the NFA for
20 the wonderful job they have been doing on that.
21 In terms of interaction with other
22 rules -- so this is not something the CFTC or the
23 Prudentials have done, but I need to mention it -- is

1 that the SEC finalized the rule on margin requirements
2 in June. And while there are significant differences
3 with the WGMR-based standards, the commissions and
4 staff at both agencies -- and thank you, Commissioner
5 Quintenz, for your efforts on that -- they have
6 endeavored to close gaps to facilitate for those
7 entities that are subject to not just the SEC rules but
8 other rules, including the CFTC. And, you know, of
9 particular note is that for a standalone security-based
10 swap dealer that is also a swap dealer that has below a
11 certain level of activity, the SEC has allowed for
12 compliance with their rules by compliance with the CFTC
13 rules. So a kind of substituted compliance with us.
14 And I think that was just -- that is one of many, many
15 changes that the -- to the proposed rule by the SEC
16 that does facilitate compliance for dual registrants.
17 Then also I want to mention in terms of
18 substituted compliance internationally, the CFTC has
19 responded to requests for substituted compliance from
20 major swap jurisdictions. So you will see that. And
21 we think that is a major tool to ease compliance for
22 many, many entities.
23 We currently are working a comparability

1 determination for the U.K. in the event of Brexit, just
2 specific to the U.K. And we have I think responded to
3 almost every request that has come from any major
4 jurisdiction. And there are some that we haven't
5 received a request yet. So it is hard for us to act.
6 But we have reacted to that. And I want to thank Frank
7 Fisanich, our chief counsel in DSIO, for that.
8 Now, industry and the public have brought
9 forth many, many other issues, some of which will be
10 mentioned later today. Since we don't have anything
11 imminent or that we have done on that, I won't discuss
12 them, but I look forward to those being brought in the
13 presentation later today because this is an excellent,
14 this committee is an excellent touch point for staff to
15 listen and develop further understanding. And thank
16 you.
17 CHAIRPERSON KARNA: Thank you, Mr. Gibson and
18 Mr. Martinez.
19 In order to allow staff to listen and develop
20 further understanding, I would like to just open up the
21 floor with a broad question. We heard a lot about the
22 notice of proposed rulemaking from Mr. Gibson and
23 similar initiatives that the CFTC has been engaged in

1 since we last met. I am wondering if people can give
2 their perspectives on whether that notice of proposed
3 rulemaking goes far enough in addressing the challenges
4 faced with respect to the margin requirements that we
5 are talking about today. Any additional suggestions
6 for the regulators on what they could do with respect
7 to margin rules?
8 (No response.)
9 CHAIRPERSON KARNA: Apparently you have done
10 an excellent job.
11 (Laughter.)
12 CHAIRPERSON KARNA: Mr. Cisewski?
13 MR. CISEWSKI: So I have a couple of
14 questions if you don't mind. The FDIC and the OCC's
15 proposal, one element of that proposal would eliminate
16 initial margin for inter-affiliate transactions. Is
17 that right?
18 MR. GIBSON: (Nodding head.)
19 MR. CISEWSKI: I wonder if you could just for
20 the public and for the record, so to speak, explain the
21 purpose of inter-affiliate derivatives transactions?
22 And then I will have a couple of follow-up questions.
23 MR. GIBSON: Sure. So within a consolidated

1 group, there is going to be many legal entities. And
2 different legal entities are facing different
3 customers. So within the group, there is often
4 transactions among affiliates that are redistributing
5 the risk around the groups, sometimes so it can be
6 centrally managed in one place, sometimes because a
7 customer wants to face a legal entity in a particular
8 jurisdiction and the firm might prefer to have the risk
9 managed out of, you know, London or New York, for
10 example. So there is a variety of, usually a variety
11 of, reasons why that might happen.
12 MR. CISEWSKI: So it is quite literally
13 transferring risk between legal entities within a
14 corporate group, right? And the risk management entity
15 could be an entity in the United States, and it could
16 be a bank, for example, with depositors or it could be
17 some other type of regulated entity in the United
18 States with customer funds.
19 MR. GIBSON: (Nodding head.)
20 MR. CISEWSKI: That is a yes?
21 MR. GIBSON: Yes.
22 MR. CISEWSKI: And we will continue to impose
23 under the proposal variation margin requirements. Is

1 that right?

2 MR. GIBSON: (Nodding head.)

3 MR. CISEWSKI: And those would account for

4 market risk for the transactions?

5 MR. GIBSON: Mark-to-market, yes.

6 MR. CISEWSKI: And the required IM that would

7 be required today, that would account for other types

8 of risks. Could you explain what those risks are in

9 the event of a default of the affiliate, for example?

10 MR. GIBSON: Sure. So the initial margin is

11 a protection, as you said, against default of a

12 counterparty. So the variation margin would protect

13 against mark-to-market changes from day to day. And

14 the initial margin is extra protection, whatever

15 happens between the time when the entity stops meeting

16 its variation margin and the actual default occurs and

17 the defaulted exposure is then crystallized, I guess

18 you would say. So because the defaults don't happen

19 instantaneously, the initial margin is a protection

20 against the price moves that might happen over that,

21 you know, pre-default period.

22 MR. CISEWSKI: And that is modeled using

23 certain assumptions and specifications --

1 MR. GIBSON: Yes.

2 MR. CISEWSKI: -- specific to the portfolio

3 of the affiliate. Is that right?

4 MR. GIBSON: Right. So for the initial

5 margin requirements under the international standards,

6 you are allowed the option of using a model that has

7 been approved by your regulator or you can use a

8 standardized GRID that has simpler calculations that

9 are just based on the type of the derivative, for

10 example.

11 MR. CISEWSKI: And so margin period of risk,

12 can we talk about that? Could you explain the concept

13 and how that relates to initial margin and the

14 potential exposure calculation, for example?

15 MR. GIBSON: Sure. So margin period of risk

16 is the time period that I was just talking about where

17 it is the time period right before the counterparty

18 defaults, where maybe they have stopped making their

19 variation margin payments because they are on their way

20 to defaulting. And over some time period, the

21 counterparty, the non-defaulting counterparty, is going

22 to be exposed to the risk of market moves. So that is

23 what is meant by the margin period of risk.

1 MR. CISEWSKI: And the assumption currently
2 for an inter-affiliate transaction within a bank
3 holding company that would move risk, let's say, from a
4 foreign affiliate to a U.S. bank, what is the margin
5 period of risk that we would apply to those inter-
6 affiliate transactions?
7 MR. GIBSON: I don't know. I don't know the
8 answer to that question. I am sure there are some.
9 MR. CISEWSKI: Do you know by chance, Rafael?
10 MR. MARTINEZ: So what is a margin period of
11 risk that they would do without requirements that --
12 MR. CISEWSKI: For initial margin imposed on
13 inter-affiliate transactions.
14 MR. MARTINEZ: Where there is no requirement
15 you mean, no requirement from these rules because in
16 these rules, I believe, at least on CFTC rule for
17 inter-affiliate margins with certain entities, there is
18 some, not all -- the CFTC has requirements with broad
19 exceptions for inter-affiliate transactions. Those
20 that don't fall into one of these exemptions, they have
21 a five-day margin period of risk.
22 MR. CISEWSKI: A five-day? So the assumption
23 is essentially that in the event of the affiliate

1 defaulting within five days, you should be able to
2 hedge out your risk and/or liquidate positions in a way
3 that mitigates the risk to the risk management entity.
4 Is that right?
5 MR. MARTINEZ: Well, that is what the
6 requirement is. The assumption that you take exactly
7 that amount would depend, of course, on the subs.
8 MR. CISEWSKI: Right. So that is a five-day
9 period right now for some transactions, but that is a
10 sort of uniform rule for some complex portfolios
11 between affiliates. It could actually take longer, in
12 which case there would be some residual risks. For
13 some other portfolios, it might take one or two days.
14 You could very easily manage your risks there. So how
15 did you arrive at the five-day period or what was the
16 thinking, just in a nutshell?
17 MR. MARTINEZ: Well, the 10-day period of
18 risk was sort of the starting point, so because that is
19 used and had been used for many, many years as for the
20 calculation, for capital calculations. And so those
21 are things that are already used by entities in their
22 calculation for capital. And we didn't want to have
23 multiple numbers floating around or burden further the

1 development of systems.

2 For inter-affiliate, we thought that it was

3 appropriate to have a shorter period of risk because

4 inter-affiliates have a better sense. When a

5 counterparty defaults, many times, it is a bit of a

6 could guess our price for the counterparty. Right? So

7 we might get that from your affiliate, you have a

8 better sense of what the state would be of an

9 affiliate. And we also thought that the company

10 itself, operationally it would be easier to protect

11 themselves from a default than when it is a

12 nonaffiliated counterparty.

13 MR. CISEWSKI: Right. So you were trying to

14 come up with a rule that was tractable, but there could

15 be portfolios that are especially complex where there

16 is some residual risk at the risk management entity.

17 There could be portfolios where that is more than

18 adequate. Is that right?

19 MR. MARTINEZ: That is correct. There is

20 always that tradeoff when you write the

21 rule -- right? -- in which you are trying to find

22 something that can be complied with by all the entities

23 that are going to be subject to that rule. It is also

1 something that is going to be easier for your examiners
2 to evaluate. And so it is easy to understand, easy to
3 apply, and roughly right or at least not grossly wrong,
4 though, of course, you know, the same happens with the
5 speed limits or anything like that, right?
6 MR. CISEWSKI: So the purpose for an inter-
7 affiliate transaction is to move risk around the
8 corporate group. The risk could be moved to the United
9 States. And it could be moved to a bank entity, for
10 example. And there are certain assumptions about what
11 that initial margin requirement will be. Those
12 assumptions for many portfolios may sort of adequately
13 account for the potential exposure. And in other
14 cases, we just acknowledged it may not actually account
15 for that. And now we are proposing to eliminate
16 required initial margin altogether. So how do we look
17 at managing potential exposure in the absence of a
18 required initial margin for, for example, a U.S. bank
19 entity?
20 MR. GIBSON: So with respect to U.S. bank
21 holding companies, there is a lot of transactions among
22 affiliates because they are global groups and they have
23 lots of legal entities. So there is existing

1 protections and regulations in place on affiliate
2 transactions and affiliate exposures that provide some
3 safeguards. So those are still in place and aren't
4 being changed.
5 MR. CISEWSKI: So, for example, Reg W?
6 MR. GIBSON: Yes.
7 MR. CISEWSKI: Is that what you are referring
8 to?
9 MR. GIBSON: Yes.
10 MR. CISEWSKI: Okay. And Reg W would apply
11 to transactions between certain affiliates but not all,
12 right? So if it is a transaction between bank chain
13 entities, Reg W would not apply initial margin
14 requirements, for example, to that transaction between
15 a bank chain entity?
16 MR. GIBSON: I am not sure what bank chain
17 entity is, but, generally, Reg W applies to protect the
18 depository institution.
19 MR. CISEWSKI: So in the case of a bank chain
20 entity, my understanding is -- and perhaps Mr. Yamada
21 or Mr. Klein can weigh in on this but that Reg W
22 requirements would not apply. And, in any event, it
23 would require an arm's-length transaction that would

1 not necessarily impose required initial margin, at
2 least at the level that would be required under the
3 regulations currently.
4 So my only point in all of this is to say
5 that by eliminating initial margin requirements under
6 the prudential proposal for some of the prudentials, I
7 should say, we actually are allowing risk to come back
8 to the United States quite directly to regulated
9 entities that have customer funds at risk or depositor
10 money at risk. And that poses a number of concerns,
11 not only for financial stability but also in terms of
12 whether the FDIC and the OCC, which have the primary
13 mandate of protecting, for example, a national bank or,
14 you know, a bank with -- or other type of bank in the
15 United States, specifically to that legal entity, that
16 they are actually allowing risk to come into that
17 entity, which is quite puzzling.
18 CHAIRPERSON KARNA: Mr. Klein, do you have
19 some feedback?
20 MR. KLEIN: I just wanted to go back to some
21 comments that Michael made when he introduced the rule
22 proposal and described the rationale behind eliminating
23 the inter-affiliate initial margin requirement. And I

1 think we talk not about transferring risk but about
2 managing risk. And I think that is one of the primary
3 concerns that imposing initial margin requirements can
4 distort internally the ability to manage risk centrally
5 by not moving risk around but by distributing risk in a
6 way that makes it easier for the entity to manage that
7 risk and to reduce the risk, not to put the risk
8 someplace else. And I think it is important to keep
9 that in mind.
10 I also would hearken back to Michael's
11 comments about the existing rule 23A and 23B
12 requirements in Reg W that do impose very substantial
13 restrictions on the ability within a bank holding
14 company to engage in certain transactions with the
15 deposit-taking institution and its immediate affiliates
16 and, in fact, require collateralization of many of
17 those transactions. So, again, there is an existing
18 protective mechanism, particularly designed to protect
19 the deposit-taking institutions, and a desire among
20 bank holding companies to be able to put risk in a
21 place where they can visualize it, manage it, and
22 reduce it.
23 CHAIRPERSON KARNA: Thank you.

1 Mr. Colby?
2 MR. COLBY: Hi. Jim Colby. I am the
3 treasurer of Honeywell. I also represent the Coalition
4 for Derivatives End-Users.
5 You were asking about why companies use
6 inter-affiliate trades. The primary reason companies
7 use inter-affiliate transactions and just using our
8 company as an example -- we have 1,000 legal entities
9 around the world that have risks that we try to manage.
10 If each of those entities independently hedge those
11 exposures, many of which are offsetting, it is very
12 inefficient. We would have unnecessary documentation
13 requirements. We would be using more bank credit lines
14 than we really need. And we would have people engaging
15 in derivative transactions that really don't understand
16 how to risk-manage those transactions as much as we do
17 at the head office.
18 So what we do is we calculate the businesses.
19 All the different businesses around the world report
20 their exposures in to us. We centralize them. We net
21 them down by risk category and hedge the net risk
22 externally with a bank. And so what this allows us to
23 do is to dramatically reduce the amount of external-

1 facing derivatives transactions that we execute with
2 the street. And it allows us to make sure that we have
3 proper people entering into derivatives transactions
4 and controlling those transactions to make sure that we
5 are doing it properly, dramatically lowers the amount
6 of credit exposure that Honeywell has with our external
7 counterparties.
8 Those credit lines cost money. And if we had
9 to post -- and if our bank counterparties were required
10 to post initial margin, both on inter-affiliate
11 transactions and on external transactions with the
12 counterparties they hedge with, that is duplicative
13 initial margin requirements on the same transaction.
14 That increased cost, those costs are going to be passed
15 on to us as end-users, making it more costly for us to
16 hedge risk.
17 It should be pointed out that most inter-
18 affiliate transactions if the affiliate transacts with
19 the centralized treasury unit, which transacts with the
20 street or a bank counterparty, that end-user that has
21 the original exposure also has an underlying exposure
22 on the other side. So they are not taking naked risks.
23 They have a risk with their customers or with their

1 suppliers. They hedge it with the centralized treasury
2 unit. So they are hedged. Centralized treasury unit
3 has a transaction with their international affiliate.
4 And then they hedge it with a bank. So they are
5 hedged. So it is a very efficient way of managing
6 risk.
7 And I think that, you know, if you are
8 talking about imposing duplicative initial margin
9 requirements across a legal entity structure, that is
10 extremely inefficient. And I think it will reduce
11 hedging activities. It imposes costs that overweigh
12 any risk management objective that you are trying to
13 achieve.
14 CHAIRPERSON KARNA: Thank you.
15 Ms. Bradbury?
16 MS. BRADBURY: Yes. I just want to switch
17 gears a little bit. And you asked this question of if
18 we are sort of perfectly satisfied with how all of the
19 initial margin rules are going to roll out. And that
20 is kind of the central thesis of today's discussion. I
21 don't want to go through all of the things that Wendy
22 and Richard are going to highlight in the next section
23 as well as the custodians, but I think from our

1 perspective as an investment management firm, it is not
2 just the sheer numbers that are going from 40 to, you
3 know, hundreds, but we are really different. We are
4 not banks. And our businesses are organized
5 differently. You know, in my firm, we manage funds
6 that have, you know, comingled for different investors.
7 We manage separately managed accounts. You know, just
8 literally our business models are different. And so
9 what I am very encouraged is that the Commission and
10 other regulators are willing to listen to us about
11 these practical implementation issues.
12 We are not trying to get out of the initial
13 margin regime. Actually, firms like ours, you know,
14 who manage a number of hedge funds, we have been
15 posting initial margin for a very long time. So, you
16 know, come on in. The water is fine, but I think there
17 are very different specific issues. And what would be
18 great is if they could get addressed before the rules
19 hit.
20 You know, it is very striking to think of the
21 FDIC putting out the inter-affiliate margin thing after
22 banks have posted $40 billion of inter-affiliate
23 margin. Right?

1 So I don't know what the right or wrong
2 answer is. I will stay out of that. I am not a bank.
3 But it is great that you are actually looking at these
4 things before the rules will hit most investment firms
5 and other non-dealer entities. And we really
6 appreciate that, that attention.
7 And I would encourage you. I have read both,
8 you know, Richard and Wendy's remarks. And they have a
9 lot of just really practical issues that we need advice
10 on and we may need rule changes on as well as a little
11 more global harmonization, how you invest the
12 collateral. They are just sort of things where the
13 rules interact with our fiduciary duties and our
14 investment objectives for our underlying investors. So
15 thank you.
16 CHAIRPERSON KARNA: I am sensitive to time.
17 So, Ms. Belich, I am going to give you the last
18 question in the room, comment in the room. And then we
19 will shift to the buy-side panel after we check some
20 phones.
21 MS. BELICH: Great. Thank you. I will be
22 very quick.
23 Same as Darcy, just not to take away from the

1 discussion we are going to have later, but as a
2 prudentially regulated bank, I think the additional
3 kind of items that we would be seeking clarity on again
4 I think that will be discussed later are, you know,
5 being a dealer's responsibility to kind of monitor and
6 look at what these calculations are for the
7 documentation relief, part specifically of the rule.
8 What does that look like for us? And what are the
9 expectations? You know, are we looking at this daily?
10 Are we looking at this at other types of frequencies?
11 You know, from the Prudential Regulators' perspective,
12 what is effective risk management in that area for a
13 swap entity and banks?
14 And, then, just to kind of brush on what we
15 were talking about earlier with the inter-affiliate,
16 you know, of course, just to kind of reiterate that,
17 you know, there have been inter-affiliate exemptions
18 that we have seen the Commission offer in other parts
19 of the rule that have covered on that effective risk
20 management portion and that have worked well for banks
21 and haven't created any additional systemic risk.
22 CHAIRPERSON KARNA: Thanks.
23 Before we switch to the next panel, do we

1 have any comments or questions from the phone?
2 (No response.)
3 CHAIRPERSON KARNA: Wonderful. Thank you
4 very much, Mr. Gibson and Mr. Martinez. And I welcome
5 the second panel.
6 (Pause.)
7 CHAIRPERSON KARNA: Great. So now we are
8 going to switch to our second panel. And, as was
9 highlighted at the end of our last panel, we are going
10 to focus on practical implementation issues,
11 specifically the buy-side's perspective on uncleared
12 margin rules. Our presenters to start us off are
13 Richard Grant, who is the global head of regulatory and
14 government affairs, the associate general counsel of
15 AQR Capital Management; and Wendy Yun, managing
16 director and associate general counsel, Goldman Sachs
17 Asset Management. Please go ahead.
18 MR. GRANT: Great. Thanks, Angie. And thank
19 you, Commissioner Stump, for sponsoring this committee
20 and the rest of the Commission for your engagement on
21 the issues.
22 I have been asked today to represent the
23 Managed Funds Association and share buy-side

1 perspective on implementing regulatory initial margin,
2 grateful for the opportunity and want to start by
3 conveying our appreciation to the CFTC for your
4 leadership responding to industry concerns on this
5 topic, which include former Chairman Giancarlo's letter
6 to Vice Chair Quarles and the interpretive guidance
7 from former DSIO Director Kulkin. I thought that the
8 committee might benefit from an inside look at what we
9 are doing at AQR to come into compliance with
10 regulatory IM requirements. I hope this will give you
11 a better sense of the heavy lift the regulation
12 requires for individual buy-side entities as well as
13 some concrete examples of the complexities we are
14 working through.
15 At AQR, we manage a number of different types
16 of accounts that will be subject to regulatory initial
17 margin, including both individual and multimanager.
18 Given the far-reaching scope of Reg IM, we formed an
19 internal working group over two years in advance of the
20 relevant deadline.
21 The project touches on a number of different
22 aspects of the firm. And our group includes
23 representatives from eight different entities or

1 offices within the firm: legal to analyze rules and
2 negotiate documents; our operations team to develop
3 internal systems and processes for the transfer and
4 tracking of daily margin calls; our engineering team to
5 create a program for calculating and tracking AANA in
6 multiple jurisdictions; our counterparty risk team for
7 SIMM vendor selection and determining the scope of
8 acceptable collateral from dealers; portfolio finance
9 to work through the SIMM calculation and methodology
10 and analyze the Reg IM impact on free cash and the
11 investment of initial margin; our compliance team to
12 develop and test policies, procedures, and reporting
13 required in certain jurisdictions; our portfolio
14 implementation team to analyze the cost and impacts of
15 OTC instruments subject to the rules; and, finally, our
16 trading team to determine the optimal instruments to
17 use under the new regime based on market response and
18 pricing. Now, this group is currently working through
19 a series of key milestones for implementing the rule,
20 which cover many of the topics I just mentioned,
21 including other items, like securing custodial
22 relationships, client communication and education,
23 counterparty testing, and the overall cash management

1 process.

2 As with any project of this scope, a number

3 of challenges have arisen each step along the way. The

4 challenges are not insurmountable for buy-side firms,

5 but I hope that hearing them will provide you with some

6 detail and color on the process we are going through

7 and also context for why buy-side firms continue to

8 seek assistance from regulators to ease some of the

9 burdens.

10 So a few of the specific challenges I will

11 highlight today are the AANA calculation. And although

12 the calculation itself seems fairly straightforward,

13 the global nature of the initial margin regime adds

14 complexity to the building of a system to compute and

15 track the calculation because it must account for

16 jurisdictional differences related to product scope,

17 calculation methodology, and the calculation timeframe;

18 also SIMM vendors. Now, calculating daily margin will

19 be facilitated for many of us by third party SIMM

20 vendors, but outsourcing that process creates its own

21 challenges.

22 We at AQR have met with a number of the

23 vendors. And many of them do not yet have the

1 capabilities to handle all of the products required for
2 in-scope accounts. That limits our ability to
3 effectively test these systems.
4 Operational challenges. A significant amount
5 of effort is required to build the pipes necessary to
6 implement the rules. For example, selecting a SIMM
7 vendor is really only the first step in the developing
8 of the capabilities to calculate and transfer initial
9 margin.
10 Next, we have to build a system to convey the
11 relevant portfolio positions to the SIMM vendor and
12 then receive back the resulting SIMM calculation. That
13 number must then feed into another new system that
14 compares it to the dealer-provided initial margin
15 number to confirm the final amount that is owed.
16 Next, a file containing the final margin
17 number must feed into the firm's existing system for
18 calculating and transferring margin so that a wire
19 transfer for the ultimate regulatory IM can be
20 executed. As you can imagine, the technology and
21 systems integration challenges related to this process
22 are extremely time- and resource-intensive.
23 Finally, legal agreements. Legal

1 documentation challenges associated with the rule are
2 frequently discussed as a headache. At AQR, we already
3 have tri-party agreements in place to post negotiated
4 initial margin with custodians. Yet, for each in-scope
5 account, we will need to negotiate new tri-party
6 agreements with each dealer counterparty for posting
7 our regulatory IM along with separate tri-party
8 agreements for the initial margin posted by those
9 dealers.
10 Now, in addition to these tri-party
11 agreements, we will also need to negotiate ISDAs and
12 CSAs with each counterparty to govern regulatory IM.
13 Each of these time-sensitive negotiations will stretch
14 the bandwidth of even the most sophisticated buy-side
15 firms' custodians and dealers.
16 Now, given these numerous challenges, what is
17 our takeaway? It seems obvious, but I think we must
18 acknowledge that we are likely to see a rush near the
19 final deadline, even the extended deadline, as the full
20 universe of in-scope accounts seek to comply. And this
21 could put a significant strain on the industry. This
22 rush will not solely be due to the relative
23 preparedness of buy-side firms. Many of the challenges

1 with regulatory initial margin relate to other parties
2 in the system, be they SIMM vendors, dealer
3 counterparties, or custodians. And each of these
4 entities will need to make their own judgments calls
5 about where to deploy their resources for Reg IM
6 onboarding. So there is a very real chance that some
7 buy-side firms will see their implementation delayed,
8 despite their best efforts to plan ahead.
9 Now, the question before this committee is
10 what regulators can do about the situation. While many
11 of the challenges I just mentioned might arise with any
12 project of this magnitude and cannot be solved by the
13 regulatory community, we believe that any action
14 regulators take to ease the overall burden on industry
15 will pay huge dividends by allowing resources to be
16 focused on the most important aspects of the new
17 regime. To that end, the initial margin phase in
18 threshold recently introduced was a very positive
19 development. And I would also point to comment letters
20 by MFA and other industry groups that provide helpful
21 suggestions.
22 However, the one regulatory action I want to
23 discuss today is resolving the current mismatch between

1 the treatment of physically settled FX swaps and
2 forwards in the AANA and initial margin calculations.
3 Forcing these products to be included in the AANA
4 calculation, even though they don't require initial
5 margin, places an undue burden on firms and the
6 financial system as a whole without a clear regulatory
7 benefit. An example might be helpful on the point.
8 Take a managed futures fund with large FX and
9 futures positions. That fund would generally prefer to
10 use futures contracts, rather than swaps, to gain
11 exposure in a given country. However, if the desired
12 exposure relates to a futures contract that is not
13 approved by the CFTC, such as SMI, the Swiss Market
14 Index, then the fund would use a swap. In that
15 scenario, a fund may exceed the $8 billion AANA
16 threshold and become in scope under regulatory initial
17 margin, almost entirely because of its physically
18 settled FX positions. Yet, it is extremely unlikely
19 that it would ever post initial margin given its small
20 OTC swaps exposure and the $50 million IM threshold.
21 Despite recent guidance on systems and
22 documentation needs for funds that are unlikely to
23 exceed the $50 million margin threshold, as an in-scope

1 fund, it would still need to be included in systems
2 that track the AANA calculation and monitor the initial
3 margin against a threshold. This type of incremental
4 burden for a single fund is magnified when extended
5 throughout the global financial system. By adjusting
6 the mismatch for physically settled FX swaps and
7 forwards, regulators could free up resources for
8 industry to use on entities with much more meaningful
9 OTC swaps exposures that are the real focus of the
10 rule.
11 With that, I thank you for the opportunity to
12 share our experiences. And I will turn it over to
13 Wendy for her perspective.
14 MS. YUN: Great. Thanks, Richard. Thank
15 you, Commissioner Stump, for hosting today's meeting
16 and for your focus on this important issue for us. I
17 also thank the chairman and other fellow commissioners
18 as well as the members of the GMAC Committee for the
19 opportunity today to discuss some of the outstanding
20 issues that asset managers and our end-user clients
21 continue to face in implementing the later phases of
22 the mandatory initial margin rules.
23 First, please note that the views I have

1 expressed today are my own and those representing the
2 SIFMA Asset Management Group, or AMG, and not of my
3 firm. We also fully commend and support the actions
4 taken by BCBS-IOSCO, the June 23rd statement, and the
5 recent Prudential Regulators' proposal to extend the
6 implementation periods and splitting phase 5
7 essentially into 2 separate phases and adopting a $50
8 billion AANA threshold for 2020. We would also support
9 the March 5th BCBS-IOSCO statement as reflected in the
10 CFTC advisory 1916 and the Prudential Regulators'
11 proposal to also not require documentation, operational
12 or custodial setups unless the initial margin does
13 exceed the 50 million IM threshold.
14 We would strongly encourage, though, that
15 global regulators adopt both standards so that we can
16 achieve much needed regulatory consistency and clarity
17 across jurisdictional requirements. Absent such, it
18 will cause a lot more disruption and uncertainty in how
19 to implement the rules in the final stages for many of
20 us. While those actions would provide some much needed
21 time for us to get ready for the last two phases, I
22 think it is important to highlight that that by itself
23 will not solve for some of the scoping and

1 implementation challenges that we as asset managers and
2 our end-user clients are confronted with.
3 By way of background, many of us manage money
4 for a wide variety of different types of clients,
5 whether it be corporates, you know, sovereigns, large
6 pension funds, you know, central banks and other types
7 of entities, each of which we typically are hired by
8 that client to employ a specific investment strategy.
9 Many clients do hire multiple asset managers because
10 they want to, one, diversify their investment
11 portfolio; and, two, take advantage of the expertise
12 that that particular manager has in a particular
13 mandate or strategy; and, three, to diversify any kind
14 of concentration risk they would have to any one of
15 them.
16 In these types of arrangements, many of us
17 set up our own trading agreements for our clients. And
18 we have no transparency nor control into the trading
19 activity of our clients outside of our mandates. As a
20 result of this practice, it makes it quite challenging
21 for us to implement some of the key features of the UMR
22 rules, more specifically in relation to the AANA
23 calculation, the sharing of the 50 million IM

1 threshold, and MTAs. You know, these parts of the
2 rules require us to have concerted efforts to collect
3 data on an aggregate basis. And, unfortunately, in
4 many cases, the burden, you know, lies with our
5 clients. Our clients are the ones who then have to
6 collate and aggregate the information, not only for
7 their own asset managers across the different trading
8 mandates that they employ but also of any kind of
9 consolidated affiliates that they are also consolidated
10 with from a financial statements perspective.
11 Some clients have already highlighted that
12 they will not be able to get the information from some
13 of their affiliates because they don't have any type of
14 transparency or relationships with those affiliates to
15 gain knowledge of the information. Other clients have
16 expressed concerns and we, too, have concerns about how
17 they will calculate the AANA amount. Some of us
18 already reached out to clients and asked them to
19 confirm whether or not they exceed the AANA threshold.
20 Unfortunately, some have gone out earlier and asked
21 about the 8 billion. Others have asked about the 50
22 billion. Some have asked about both. And it has also
23 been a mixed bag in terms of how much detail, how much

1 information you are collecting from those clients.
2 Some have gone out and asked clients to just highlight
3 if they exceed a general number, like five billion or
4 six billion, and to come back to the asset manager to
5 the extent they do so that the asset manager can work
6 with those clients more closely to refine their
7 calculations and determine whether or not they truly do
8 exceed the AANA threshold amounts. Others have gone
9 out with more specificity and asked clients to
10 calculate the AANA amounts across different
11 jurisdictions, whether it be March, April, May, June,
12 July, and August, across different types of asset
13 classes or, you know, different types of products.
14 As you know, in the different jurisdictions,
15 there are different requirements. Some instruments are
16 in scope in some jurisdictions. Some are not. So the
17 inclusion of equity options, potentially TBAs, the
18 definition of FXforwards or spots, those all differ
19 from jurisdiction to jurisdiction. So it becomes quite
20 challenging to give a client guidance as to the
21 specific calculation that they must do in order to give
22 you the accurate information per jurisdiction for you
23 to then get the aggregate number.

1 As a result of all of this, we do see that
2 there is likely to be delays in the implementation and
3 the response feedback from our clients with their AANA
4 information, which puts more pressure on asset managers
5 in the buy-side in terms of the implementation once you
6 get confirmation if the client does exceed the AANA
7 threshold amounts. By virtue of having to wait for
8 that confirmation because the asset managers and the
9 dealers with whom we trade do not have the transparency
10 as to the clients' overall trading activity. That
11 means we have to wait and see whether or not the
12 clients come back to us with confirmation that they are
13 over the amount and then immediately start working with
14 the dealers to determine whether or not we also exceed
15 the 50 million IM threshold.
16 While we appreciate the time and the
17 confirmation from many of the regulators that we don't
18 have to employ documentation and the operational
19 readiness in order to comply until we exceed the 50
20 million, again, that is a number that we are not in
21 control of. And we don't have any transparency as to
22 when the client may see that number with a dealer and
23 its affiliates. All we can see is the trading activity

1 that we carry out in our own portfolios for our
2 clients. And so at any given time, the dealer may call
3 us and tell us that now the client is in scope, either
4 because they have crossed the internal threshold set by
5 that dealer or the 50 million in the aggregate.
6 This poses a lot of concerns for us because
7 now without any notice, we will have to scramble to try
8 to get resources focused on getting ready with that
9 particular dealer for that particular client. And,
10 unfortunately, as asset managers, we do not hold the
11 assets of our clients. We cannot choose their
12 custodians because we don't have the authority and the
13 investment management agreement for us to do so. We
14 would need to potentially amend our IMAs to give us the
15 authority to actually select their tri-party custodian.
16 We would also then potentially have to think about
17 other issues, such as, you know, the regulations that
18 apply to some of our clients, like mutual funds and
19 European-regulated funds, whereby the custodian must be
20 a qualified custodian or meet certain regulatory
21 requirements. They may have to enter into
22 subdelegation of strict liability requirements for
23 funds subject to AIFMD in terms of the third party

1 custodian holding assets of the fund pledged to the
2 swap counterparties.
3 So, for those reasons, we typically will work
4 with a client's individual custodian, rather than
5 ourselves picking a single one and setting up all of
6 the necessary trading agreements and account control
7 agreements for the tri-party segregation of the initial
8 margin. This means that there are a lot more third
9 party custodians that may not have been involved in the
10 first initial phases that are now going to be tapped on
11 the shoulder and have to get prepared for the
12 documentation requirements in the latter phases. In
13 many cases, it takes anywhere from six months to a year
14 to negotiate the tri-party IM segregation agreements.
15 And we are concerned about the readiness of some of the
16 smaller custodians, who may not have experience in the
17 earlier phases to be able to prepare for this
18 requirement.
19 The additional issue is that we all will be,
20 you know, trying to go through the same pipeline
21 getting the attention of the dealers and the custodians
22 to prepare for the necessary documentation and
23 operational setups. Again, we will go through the same

1 pipeline. We will be asking for the same attention
2 from the same resources.
3 Dealers may choose in some instances based on
4 the trading activity of the particular asset manager to
5 put some on the sidelines or to halt trading with some
6 of us based upon our trading activity versus some of
7 the other peers that might have larger trading books
8 with them. So that could be a potential disruption not
9 only to the deployment of our trading mandate but just
10 in terms of the client's performance under our assets
11 under management. So that is something that we are
12 very concerned about.
13 Once you get the AANA information, as we
14 mentioned, the focus then turns to the IM threshold and
15 the sharing of that amount. Right now, at any given
16 time, the dealer must now perform two separate
17 calculations on a daily basis: the initial margin
18 requirement in relation to their existing book as well
19 as what is the simulated initial margin that would be
20 required under whichever model that they are using for
21 initial margin and to determine whether or not that
22 amount exceeds 50 million. So that is a daily
23 requirement, maybe having to be done on a dynamic basis

1 across all affiliates trading with that client and its
2 affiliates. So you could see how much of a burden that
3 will be as well as the, you know, potential surprise
4 when clients come close to that 50 million.
5 So one of the proposals that we have
6 highlighted in the SIFMA AMG letter is to potentially
7 consider having the initial margin be calculated on an
8 annualized basis during the same relevant AANA periods
9 that currently exist under the rules, whether it be
10 March, April, May, or June, July, and August. We feel
11 that this would be an opportunity for the regulators to
12 be and the dealers to be able to focus only on those
13 types of accounts that really truly present any type of
14 systemic risk. And it would also narrow the number of
15 clients that we would be waiting to hear back from in
16 relation to potentially exceeding the $8 billion
17 figure. So it would mitigate and alleviate the
18 dependency and the latency in relation to getting the
19 client feedback in relation to their AANA calculation
20 as well as allowing people to really focus on those
21 portfolios that really truly are close to the $50
22 million thresholds. So that was something that we
23 would ask the regulators to consider and happy to take

1 any more questions about that proposal.

2 In relation to other types of issues that we
3 are confronted with include seeded funds. Many of us
4 have had seeded funds have to go early because of the
5 consolidation requirements under the CFTC rules and
6 Prudential Regulators' rules. And, unfortunately, in
7 those instances, trying to set up all of the necessary
8 documentation and trying to get the resources and the
9 attention of our dealer counterparties has been quite
10 challenging in the earlier phases. In some instances,
11 we have only been limited to less than a handful of
12 counterparties in meeting the regulatory deadlines,
13 which causes other issues for fiduciary asset managers,
14 such as, you know, achieving best execution, mitigating
15 counterparty risk and meeting counterparty exposure
16 limits under different jurisdictional requirements, and
17 just overall risk mitigation and concentration of that
18 risk in the hands of a few dealer counterparties.

19 We would urge the CFTC and Prudential
20 Regulators to consider potentially not requiring the
21 seeded funds to be consolidated. Again, it is a
22 passive investment by a sponsor firm, many of which do
23 not act in concert and have no transparency or control

1 into the trading activity of the actual seeded funds.
2 I'd also note that in Europe, the rules under
3 EMIR do not require E.U.-regulated funds to have to
4 consolidate. And in some instances, in relation to
5 some of the SICAVs and UCITS funds that also have been
6 seeded, some asset managers have intentionally made
7 sure to only limit the trading of those funds with
8 European dealers in order to take advantage of that
9 ability to deconsolidate. So, thus, you might see a
10 bifurcation of liquidity in the market and also some
11 regulatory arbitrage as people take advantage of those
12 deconsolidation abilities under other rules. In both
13 instances, we would encourage global regulators to not
14 require seeded funds to consolidate in general and in
15 Europe to not just limit this only to the European-
16 regulated funds but for all seeded funds.
17 The other issue that we would like to
18 highlight is in relation to the types of collateral
19 that are permitted. In many cases, as a CFTC study has
20 highlighted, you know, in the past, you know, most
21 asset managers and their end-user clients have used
22 cash as collateral. I think the CFTC study had shown
23 over 77 percent use it for variation margin. This is

1 because that it is the easiest form of collateral to
2 transfer. There are no margin haircuts on it. You
3 avoid settlement issues. You don't need traders or
4 other employees buying and selling, you know, different
5 types of noncash collateral, such as Treasuries,
6 dealing with odd lot sizes or settlement issues. And
7 this is extremely important as, you know, the
8 timeframes and compression for margin transfer timing
9 has continued to condense. So for us, the ability to
10 be able to use cash as an eligible form of collateral
11 and take advantage of the services of many custodians
12 in sweeping that cash into money market funds and
13 pledging that as collateral is something that we would
14 like to continue to be honored.
15 Under the CFTC rules and Prudential
16 Regulators' rules, there are some limitations to the
17 use of money market funds, such as the ability of those
18 money market funds to engage in repos and securities
19 lending-type transactions. We feel that those types of
20 limitations are burdensome and unwarranted. If you
21 look at other CFTC rules, such as in relation to the
22 regulation 1.25, for any type of money market funds
23 that are government-only, there is no limit on the use

1 of those types of money market funds as reinvestment,
2 for reinvestment purposes of customer margin. So we
3 would ask that there is similar consistency in relation
4 to the treatment of money market funds under these
5 regulations.
6 In Europe, even though there is also
7 recognition of money market funds, there are also
8 similar limitations in relation to their use. Again,
9 we would ask the global regulators to examine these
10 limitations and whether or not they should be removed
11 so that we can continue the practice of using them. It
12 helps us not only mitigate our exposures to the
13 custodian banks, but also it helps us to be able to
14 meet the necessary transfer timing and the ability to
15 continue to use cash and avoid the settlement issues
16 that we would face with transferring noncash
17 collateral.
18 The last thing I would highlight is in
19 relation to FX. As Richard highlighted, the inclusion
20 of FX means that there is probably 30 percent more of
21 clients in scope for phases 5 and 6 than are warranted.
22 Many of them will not exceed the $50 million IM
23 threshold.

1 And also, as Commissioner Quintenz had noted
2 earlier, the use of notional as a blunt instrument in
3 measuring risk here is somewhat punitive because in the
4 case of FX, many times people will offset their risk in
5 their books by entering into offsetting transactions.
6 This means you have two directional trades, both of
7 which will count from a notional perspective towards
8 your AANA calculation, even though despite your risk
9 portfolio is essentially flat. So we would ask that
10 you reconsider and take a look at whether or not FX
11 should be excluded from the AANA calculations on a go-
12 forward basis.
13 The last thing I would mention, too, is in
14 relation to the models. In relation to what Rafael
15 Martinez had highlighted earlier, some jurisdictions
16 require us to use models and do the back testing.
17 Already it is a challenge for us from an operational
18 perspective. Right now, we are having conversations
19 with our dealer counterparties, not only to determine
20 what regulations they are applying, whether or not they
21 are using in some cases EMIR versus Dodd Frank rules
22 because many dealers are subject to multiple
23 jurisdictional requirements based on their trading

1 activity but also different models that they may be
2 employing for different asset classes. For us to be
3 effectively able to manage and to check the margin
4 requirements, we need to know whether or not dealers
5 are using the SIMM calculator, the GRID, or their own
6 proprietary models. And then we have to decide whether
7 or not it is worth it for us to build out our margin
8 models or to use vendors to be able to replicate so
9 that we don't have any breaks when exchanging margin
10 with those particular dealers.
11 In some instances, I am afraid that, you
12 know, for some end-user clients, the cost may be too
13 heavy and too much to be able to support and justify
14 the use of derivatives. They may be an elimination of
15 certain counterparties based upon the fact that they
16 have different jurisdictional requirements, it is too
17 complex or complicated, or it may take too many
18 resources to dive into their rules and their
19 requirements and absent substituted compliance or
20 deference by the global regulators, we may have no
21 choice but to potentially turn off some of those
22 trading lines unless we want to do the actual work, you
23 know, to be able to comply with their other

1 jurisdictional requirements.

2 I will stop there for any questions that the
3 panel may have.

4 CHAIRPERSON KARNA: Thank you, Ms. Yun and
5 Mr. Grant, for your very detailed presentation of both
6 some of the challenges that you are facing on the buy-
7 side as well as some proposed actions, which I am sure
8 the regulators in the room are very appreciative of.

9 I would like to take a few minutes just to
10 get feedback from other GMAC panel members, both on the
11 comments around challenges and actions that our
12 panelists raised but also if there are any other
13 challenges or actions that you would recommend from a
14 buy-side perspective. Ms. Guest?

15 MS. GUEST: While I am not speaking from a
16 buy-side perspective, I really thank you for your
17 remarks. It is really helpful to have had you shed
18 some light on the challenges. And I think from this
19 perspective of end-users and smaller swap dealers, I
20 think a lot of those challenges are shared.

21 One that Mr. Grant glossed over a little bit
22 but I think was sort of implied in what you said is the
23 data challenges. In some cases depending upon how your

1 booking systems work, you may have different asset
2 classes that you use different booking systems for.
3 And so the data challenge of flattening that data, if
4 you will, to be able to feed everything into the model
5 can actually be an extraordinarily, massive project.
6 So I am sure that is probably part of what you guys are
7 looking at, but I did just want to call attention to it
8 because the data challenges are actually pretty
9 significant.
10 I also support a lot of what you said, Ms.
11 Yun. I think the challenges that you see are things
12 that we are seeing as well and in some ways living
13 through. And one of the things I wanted to just call
14 the committee's attention to is a letter that I think
15 came in late last night but is in the packages. It is
16 a letter from Reed Smith that highlights another
17 logistical challenge, if you will, that comes up where
18 there are conflicting models at play. And I think it
19 is really important for the Commission to take a look
20 at that on behalf of the smaller swap dealers and end-
21 users and others because there are some significant
22 challenges if you have, say, a SIMM model versus a GRID
23 model. You are simply going to see people turning off

1 and saying, “I’m not going to trade unless our models
2 are the same.” And so I think the proposal in the
3 letter is at a high level to allow effectively
4 substituted compliance but to say, “You can rely
5 on -- choose between the two. You can rely on the big
6 dealer to run their model. You will run your own risk
7 management for double-checking. But you would rely on
8 that dealer to calculate for the relationship,” which I
9 think may address some of the complexities of the
10 things you were pointing to.
11 So thank you again for you remarks. It is
12 really helpful.
13 CHAIRPERSON KARNA: Thank you.
14 Ms. Bradbury?
15 MS. BRADBURY: Yes. I just want to go a
16 little deeper on a couple of points. You covered so
17 much stuff. So, just to clarify, how often are you
18 supposed to do the AANA calculation?
19 MS. YUN: The AANA calculations are done
20 through the measurement periods prescribed by the
21 jurisdictional requirements. So, again, it depends.
22 In some cases, it is done through the June, July, and
23 August measurement period. In others, it is March,

1 April, May. In some instances, it is on a daily
2 average calculation. In other instances, it may be the
3 last day of the month. Again, it varies.
4 And so the information that you are
5 collecting from your clients if you want it to that
6 level of accuracy and specificity, you would need to
7 identify the dealer counterparties with whom you are
8 trading and the AANA requirements in relation to that
9 specific jurisdiction and ask the clients to collect
10 that data on that basis.
11 MS. BRADBURY: So you are going to a pension
12 fund client for whom you manage a piece of their money.
13 MS. YUN: Correct.
14 MS. BRADBURY: And you are asking them first
15 to do this threshold calculation regularly, right,
16 particularly if they are kind of close to the margin?
17 And then you go to every dealer you -- let's assume
18 they are over the threshold or near the threshold on
19 AANA. You then have to go to every trading
20 counterparty and ask them to do a calculation on all
21 the business they do with that pension fund but with
22 all of their managers.
23 MS. YUN: Yes. Unfortunately for the swap

1 dealers, they are not going to also have transparency
2 to the clients' overall trading activity outside of the
3 trades that are done with them. So they are reliant as
4 covered swap entities, you know, for the client to
5 confirm whether or not they exceed the AANA thresholds
6 for that particular year. So, again, there is a lot of
7 reliance. In some cases, some dealers have asked for,
8 you know, representations, which is quite alarming
9 because, again, the numbers and the feedback you might
10 be getting from clients may not be exact. It may be
11 just based on using more of a blunt calculation across
12 their portfolios and not getting into the nuances.
13 But, you know, again, once you get that information,
14 you have to go notify the dealers that that particular
15 account is now potentially in scope, has crossed the
16 AANA threshold. And that is when you begin to dialogue
17 and the focus on whether or not they also will exceed
18 the 50 million.
19 MR. GRANT: And that is where we talk a lot
20 about client communication and education, because so
21 many of these pension funds, a lot of the clients we
22 work with, they are not digging into the details of the
23 rule. So they don't understand the heavy lift that

1 they have in front of them. And then what we have even
2 seen since the addition of the new threshold category
3 or the one-year delay, we have had certain clients who
4 just say, “We heard there is a delay. Talk to us
5 later,” like not even wanting to have the conversation
6 now, though there is a bit of a lift on their part as
7 well.
8 MS. BRADBURY: And let’s say you are managing
9 a piece of a client’s portfolio and your exposure isn’t
10 that big for what you do and you are notified by the
11 client or by the dealer that you might have to put in
12 place all of the contractual things. It is obviously a
13 little hard for you to predict, but are you going to
14 just stop trading swaps for that client? You know, is
15 there going to be some sort of a degradation of your
16 investment strategy because you decided it is basically
17 just not worth it, you can’t handle or they can’t
18 handle the compliance burden to use these instruments?
19 MR. GRANT: I mean, I think there are going
20 to be a lot of individual client discussions and
21 internal discussions about what makes sense given the
22 magnitude that this happening across your entire client
23 base essentially. And it may not just be our decision,

1 but something Wendy and I have talked about before is
2 that dealers may be making decisions as they are trying
3 to think about the effort to put in place all of these
4 agreements. And at some point, they may say for a
5 given client, "I have a series of asset managers
6 working with them. And some may have only a sliver of
7 that overall account. And I am going to put them to
8 the back of the line and may not get to their
9 documentation until I have worked through everyone
10 else." So it goes both ways.
11 MS. YUN: Yes. I would agree with Richard.
12 It is not only our independent decision but, again, of
13 the dealer counterparties. And, again, it is dependent
14 on a number of factors, including the type of portfolio
15 that you are running for that particular client,
16 whether or not you can gain the similar types of
17 economic exposures through other instruments or not.
18 Again, the dealers really hold the cards, too, because
19 you may run a very small hedging book or, you know, FX
20 book with that particular dealer. They could decide to
21 put you at the back of the line or to tell you to
22 please move your positions because they would rather
23 deal with the accounts, you know, that are much more

1 heavy use of the 50 million. Now, that also puts the
2 smaller asset managers and those with the smaller
3 trading books, you know, at a more disadvantaged
4 position because, again, you know, with dealers having
5 to weigh the resources and the cost-benefits, you can
6 see how in some cases, they are going to be left, you
7 know, on the sidelines.
8 MS. BRADBURY: All right. And, then, I will
9 just make one other comment that is more from our
10 perspective, and that is that as a firm, all other
11 things being equal, we prefer cleared products. It is
12 more efficient. We have to post margin on non-cleared
13 swaps already, as I mentioned. We've had to do that
14 for a very long time. And so, you know, if we can use
15 a futures contract, it is very efficient. You know,
16 economical, it is a great thing.
17 But there are products that we need to use to
18 implement investment strategies that just aren't
19 available in a cleared form. Maybe there are
20 particular, you know, specialized, they have terms that
21 don't match. There are obviously clear business
22 reasons why that. And so I think we would really view
23 it as extremely unfortunate if all of the regulatory

1 burden, which doesn't have a clear impact on risk
2 reduction, ends up making these markets for uncleared
3 swaps less efficient, harder to access, all of those
4 things because we only use them where we don't have
5 other good choices. And I think that is just an
6 important thing.
7 You need to preserve the market for these
8 kinds of instruments and not unduly burden it. I think
9 a lot of the suggestions that are in these comment
10 letters and other things would really help reduce the
11 burdens, in particular, in ways that don't affect
12 systemic risk. And I encourage the Commission to
13 consider them.
14 CHAIRPERSON KARNA: Thank you.
15 Do we have any questions or comments on the
16 phone?
17 (No response.)
18 CHAIRPERSON KARNA: All right. With that,
19 thank you very much, Ms. Yun and Mr. Grant. And we
20 will take a 10-minute break.
21 (Recess taken.)
22 CHAIRPERSON KARNA: Great. So we are going
23 to continue our deep dive into margin with our third

1 panel, where we are going to hear about the custody
2 banks' perspectives on implementation of the uncleared
3 margin rules. We are going to start off with Dominick
4 Falco, who is the managing director and head of
5 segregation at BNY Mellon. And we will also hear from
6 Judson Baker, who is the head of product development
7 for derivatives and collateral services at Northern
8 Trust.
9 MR. FALCO: Good morning. Thank you very
10 much. And thank you very much for allowing us to have
11 the opportunity to express the view of the marketplace
12 from the custodian.
13 To maybe put this all into perspective, I
14 would just like to kind of wind the clock back to 2016.
15 I have been at the bank for about 12 years. And so I
16 have been overseeing this process since the inception
17 and, in fact, some of the buildup prior to the first go
18 live.
19 In 2016, from the BNY Mellon perspective,
20 just to give some numbers to add some context to the
21 discussion, we set up approximately 600 accounts or so.
22 In 2017, we set up a further 400 accounts. And in
23 2018, we set up about 500 accounts. This past year, we

1 set up 1,000 accounts, so, basically, two-thirds as
2 many as were in the program and live to date.
3 I would mention that there has been a lot of
4 publicity, I would say, about the first phase. And so
5 some of the delays as it related to the custodians in
6 terms of being able to set up those accounts on
7 time -- and that really was, you know, from that point
8 in time an issue of doc negotiation and, really, the
9 flow of documents. What I would say is the industry
10 has gotten much, much better in terms of their ability
11 to negotiate those documents, negotiating the account
12 control agreements, which govern the segregated
13 accounts at the same time that the CSAs are being
14 negotiated as well. So within the 1,000 accounts that
15 we set up in 2019, frankly, with very, very few issues,
16 all of those were set up on time.
17 Interestingly enough as it relates to the
18 discussions around the $50 million threshold, some
19 accounts, a further 100 of those, have actually been
20 delayed to post September 1 simply because the size of
21 the balances and the expectation for being able to or
22 requiring to exchange collateral really wasn't there.
23 So, in effect, really, this phase has been quite large.

1 Looking forward to 2020, our guesstimations
2 from our perspective is probably setting up about 2,400
3 agreements, so from that perspective more than doubling
4 where we are from this year. So, really, the road
5 forward is really an uphill one.
6 Really, from our perspective again, it
7 is -- predominantly two documents that we're the most
8 focused on, is the account control agreement as well as
9 some will say the eligible collateral schedule is a
10 separate document, but, in fact, they form a package.
11 The account control agreement is really an important
12 doc for any of the participants to determine at the
13 very, very outset which custodian and which regime they
14 actually are planning to use to segregate their
15 collateral. The custodian and the ultimate regime that
16 they and their counterparty fall under will dictate the
17 documentation that is required. There are four tri-
18 party custodians: Euroclear and Clearstream, who are
19 the ICSDs; JPMorgan; and ourselves. As you deal with
20 an ICSD versus a traditional custodian in the tri-party
21 space, the documentation is slightly different. And,
22 similarly, if you are dealing with an EU 27-regulated
23 entity -- and all four use those for the purposes of

1 dealing with EU 27 clients post-Brexit -- there are
2 additional documentation requirements that need to go
3 into play.
4 Some of the issues around the documentation
5 really are the interplay of the CSA as well as the
6 account control agreement. One of the issues that the
7 industry has raised to us on a number of occasions is
8 that it is really actually the ISDA agreement that
9 delays the finalization of the account control
10 agreements. And so oftentimes we find these
11 bottlenecks that are happening at the very, very end of
12 the negotiation period. As I mentioned, there are
13 fewer of those this year, but I can see going into 2020
14 that we would expect that that number would increase
15 again.
16 From BNY Mellon's perspective, we really are
17 doing a thorough review of our documentation. We are
18 looking at much of the optionality that we currently
19 have in our documentation and then opening that
20 optionality up further to clients so that we can reduce
21 the amount of the bespoke negotiation that we need to
22 do on a going-forward basis. Ideally, you know, our
23 desire would be to get to a non-negotiated document on

1 its surface but have a number of options that clients
2 can actually opt into or opt out of.
3 In addition, we are looking at utilization of
4 the ISDA Create program or the platform in order to
5 make doc negotiation and then ultimately the
6 consumption of those options and the documents much,
7 much faster on our side. So, really, you know, our
8 perspective is going into 2020 and 2021, we really need
9 to look at as much automation and easing the burden as
10 much as possible.
11 From the eligible collateral schedule point
12 of view, I think, you know, a lot was raised about
13 cross-jurisdictional issues. And it really is the
14 cross-jurisdictional issues that make the eligible
15 collateral schedule a little bit of a delay in terms of
16 completion. What we see is that the eligible
17 collateral schedule is generally the last document to
18 be completed, even after the account control agreement
19 and the CSA. And, really, it is an issue of the
20 regulations will require certain amounts of collateral,
21 certain types of collateral with prescriptive haircuts
22 and concentration limits. I always say if you think
23 about that the regulations put the acceptable

1 collateral into a box and then depending upon the types
2 of regulations that the counterparties are impacted by
3 in a cross-jurisdictional space, that would actually
4 make the box smaller. And then as the individual
5 parties, particularly the collateral receiver, takes a
6 look at the type of collateral and then negotiates that
7 down, it becomes smaller still. And this process often
8 takes a while.
9 What we had seen with dealers in the first
10 couple of phases was really to have equivalence in
11 terms of those collateral schedules and generally to
12 have them as broad as possible. I think as we move
13 into the buy-side -- and this we have seen with some
14 buy-side clients -- certainly with some of the alts
15 that have been impacted in the past couple of phases,
16 their view is to potentially have a wide type of
17 collateral schedule, to ultimately make the cost of
18 collateral that would be priced into the trade, as I
19 think was raised earlier, less burdensome. So the past
20 phase, we have seen more asymmetric collateral
21 schedules, as opposed to the symmetric ones that we
22 have seen in the first couple of phases.
23 A couple of other things, just really to note

1 from our perspective. We have engaged in client
2 outreach for about 18 months in terms of notifying
3 clients about the regulations, bringing in some of the
4 industry participants to explain the different pieces
5 around the regulations. And we do these in a variety
6 of roundtables with clients. Typically what we have
7 done, certainly in the U.S., is really have those
8 roundtables by client type. So we have had insurance
9 roundtables, asset manager roundtables, alt
10 roundtables. As we go internationally, what we have
11 done, really, has been more regional. So we have had
12 them in some of the key capital cities in Europe and
13 Asia as well. And, really, the importance is really to
14 raise the awareness of the regs; introduce some of the
15 issues, such as the calculation for IM and the SIMM
16 model, bringing in some of the industry constituents to
17 really explain those to clients. The feedback has
18 actually been good. And I think what we have seen is a
19 lot of engagement from clients very early on.
20 In terms of what we are seeing for 2020,
21 right now, we are already in the phase of client
22 onboarding. So the good thing I think that we have
23 seen over the past four years is the mantra that we and

1 many other industry participants talk about of it is
2 never too early to start has actually started to take
3 hold.
4 We have seen from some clients, certainly in
5 the alts community, those that are initially or already
6 posting initial amounts, so house IA or, you know, a
7 number of different phrases around that, some of those
8 clients have actually said that they want to move into
9 a tri-party structure and their intent is to actually
10 have that up and running by call it the end of this
11 year or early next year with the view of being able to
12 post their house IA and then ultimately the regulatory
13 IM through that same account.
14 One other thing that we have noted from the
15 clients that have started with us on the buy-side
16 again, predominantly alts, most of them are actually
17 using the greater of methodology of collateralizing.
18 So this is one where there is a house IA number and
19 then there is a regulatory IM number. The calculations
20 are both made. The greater of the two is the number
21 that is actually posted. Ultimately that account needs
22 to be reg-compliant. So it is documented under reg-
23 compliant documents. The collateral types are reg-

1 compliant collateral types. And so it eases a little
2 bit of the burden of having multiple accounts that are
3 out there.
4 Specifically to the number of accounts, I
5 know there has been a lot of discussion around the
6 implementation or the recommendation, I should say, of
7 the 50 million threshold. From BNY Mellon's
8 perspective, we are very supportive of this. I think
9 one of the challenges that we saw very early on in the
10 discussion was the potential for a number of accounts
11 that would need to be set up, tying up legal,
12 onboarding, and other resources within the firm, which,
13 frankly, would never be funded. And so from our
14 perspective, to not have to do that is actually a good
15 thing, rather than having to jump through all of those
16 hurdles.
17 One other thing that I really did want to
18 raise -- and I know a lot of discussion has gone on
19 around the SMAs and, really, the notification into the
20 asset managers as it relates to the ultimate asset
21 owner declaring themselves as being in scope. One of
22 the concerns I think from the custodians' perspective
23 is any delays that come in through this process

1 actually impacts us to a very large degree from the
2 perspective of KYC and AML. From our perspective,
3 whether you are a collateral provider or a collateral
4 receiver on our program, we do need to do KYC review of
5 accounts. And any delays in terms of identification of
6 those accounts has a material impact to our ability to
7 set up clients on time. From that perspective,
8 anything we can do to speed up the disclosure of
9 clients that are in scope would actually help everybody
10 through the whole process. From our side, when dealers
11 are posting to those clients, we will still have to do
12 that KYC as well as any KYC that we would do if those
13 particular clients selected our firm or any other firm
14 as their collateral-providing entity.
15 With that, I will hand it over to Jud and
16 leave it open for questions later.
17 MR. BAKER: Sounds good. Thank you.
18 I don’t want to repeat much of what Dominick
19 just mentioned, but custodians and asset service
20 providers provide generally two lines of service as it
21 pertains to uncleared margin rules. Some of our
22 clients select us to become their collateral operations
23 outsource provider. So we are the ones on their behalf

1 calculating the initial margin and facing off against
2 their counterparties, effecting the transfer of
3 securities to meet the margin regulations.
4 And, then, there is the custody side of the
5 business, where we offer collateral segregation
6 services. That second bit is what the focus is here
7 today. I guess I am representing probably some of the
8 smaller custodians that haven't been impacted, mainly
9 because the types of clients that we support are
10 entirely buy-side. We don't have any sell-side direct
11 customers. And so what we are aiming to do is to
12 provide a service for the buy-side. We think it is a
13 natural fit for our clients to keep these accounts
14 under one roof so we can effect transfers between one
15 account to the other.
16 So the starting point for us is to make sure
17 that we have a standard account control agreement. And
18 I think most people know or maybe it is -- I am not
19 sure I can use that assumption, but ISDA has a legal
20 working group where they have retained external counsel
21 and they are going through each of the major
22 custodians, at least U.S. account control agreements,
23 as well as U.K. account control agreement and any other

1 jurisdictions where their members are demanding them
2 review these agreements.
3 And custodians have been offering this type
4 of service for a number of years, decades, either to
5 support independent amounts or to support margin help
6 for U.S.-registered mutual funds under the 1940 Act.
7 So there is a lot of familiarity around this service.
8 And a lot of our clients already understand how it
9 works and how these agreements function. The great
10 benefit to a firm like us and I think other custodians
11 is going through that legal process to vet your
12 agreements would theoretically leave it to a better
13 place where you are going to negotiate downstream with
14 your clients and your dealers. There won't be too many
15 negotiable points. We shouldn't see too much of a
16 variation between one account control agreement and the
17 next. What helps us with that is that ISDA panel is
18 holding a bunch of representatives from the sell-side
19 and the buy-side.
20 So, theoretically, we like to think through
21 that that is going to help the process entirely for the
22 account opening end of things. We don't see too many
23 hurdles on our side. We can quantify the number of

1 clients that we think are on scope and at what points.
2 And we also have a view into which dealers they are
3 trading with.
4 So we have a good feel for how much business
5 will come our way for these accounts. But what we are
6 absolutely advising our clients is let's negotiate the
7 account control agreements first. And the account
8 opening process will be a trigger point down the road.
9 And, you know, from the regulatory relief that we saw,
10 I think that is a great relief, not only to the
11 custodians but to the asset owners, so they don't have
12 to, you know, start paying for services that they don't
13 need.
14 So most custodians will charge for these
15 accounts. It is like nominal account charge or basis
16 point fee of the assets in there, but there typically
17 is some kind of flat fee in there. If the accounts are
18 going to sit there dormant, then there is really no
19 point for the clients to have to pay fees. So what we
20 expect and what we are going to advise our clients is,
21 again, let's negotiate the account control agreements
22 so at least we get that out of the way. And then when
23 you get close to that 50 million threshold -- maybe it

1 is 30, 35, 40; it is up to the client -- they give us a
2 2-week notification timeframe. And then we will effect
3 the opening and alert both parties that the account is
4 open.
5 So we do see practical means for carrying out
6 these margin regulations, at least from an account
7 opening perspective. As I said before, the majority of
8 our clients for these segregation services will be
9 existing clients of our organization already. So that
10 knocks out a lot of AML KYC aspects.
11 We are starting to get interest from non-
12 custody clients of our organization. And I think it is
13 because, you know, they might be facing a queue with
14 their other provider, for whatever reasons. So we are
15 evaluating this, but one of the safeguards in play is
16 if we already have that contractual relationship with
17 that organization, we already are the custodian of
18 their accounts, it is an easier solution for those
19 organizations, as opposed to supporting this from an
20 instance where external transfers of assets come into
21 the bank.
22 Outside of that, as I said before, the
23 custodians have been providing this type of service in

1 the past. One of the fears that I think the industry
2 had is that right now, it is a heavy paper-based flow,
3 secure email, faxes, dealers logging into custodian
4 portals and things like that. I am speaking from my
5 organization. I think I am speaking for a lot of other
6 custodians. That is all going to move away. Most
7 custodians, including my organization, are adhering to
8 industry standards on how to automate these messages,
9 whether it is through SWIFT or a utility. So there is
10 relief by all parties. It does require testing between
11 mainly the dealers but also the large buy-side firms
12 with the custodians to effect that. So I just wanted
13 to point that out, that, you know, it is a pain point
14 historically but that pain point should be going away.
15 And it is for good reasons, not just to comply with the
16 margin regulations.
17 The one challenge we see with the margin
18 regulations -- and it has already been discussed. So I
19 am not going to bang on this point too much -- is the
20 eligibility rules and cash as a permissible asset. And
21 for us as a custodian, it is forcing us to offer or to
22 launch a Treasury-only fund. With that, you know, we
23 don't have too much outside interest in a Treasury-only

1 fund from our clients. They are very comfortable with
2 money market funds. So I think the only thing really
3 driving this is so that clients of ours that wish to
4 pledge initial margin as cash can continue to do so.
5 Practically speaking on our side, partnering
6 up with our asset management firm, we are looking at
7 how early that notification needs to come to us to move
8 the cash, whether it has to be first invested in a
9 Treasury fund and then transferred as an investment
10 into that seg account or can it just come in the form
11 of cash and be reinvested into that Treasury fund.
12 There are some operational hurdles that we as a
13 custodian have to go through. There are certainly
14 haircut calculation concerns that the dealers are
15 facing when cash is permissible on whether or not they
16 apply a zero haircut overnight or is it an 8 percent
17 haircut, 12 percent haircut? You have got to look at
18 the underlying fund. So there are complications now
19 that we all are wrestling with because of the
20 eligibility rules and the reinvestment of cash as
21 margin.
22 I think that pretty much covers all of the
23 things that I want to talk about. So I will open it up

1 to questions or comments.

2 CHAIRPERSON KARNA: Thank you very much.

3 With that, I am opening it up for questions or comments

4 from panel members. In particular, have you yourselves

5 experienced any particular challenges, either raised by

6 our panelists or otherwise, with respect to custodial

7 arrangements? And in the interest of being solution-

8 driven, do you have any suggestions for ways to address

9 some of those challenges?

10 (No response.)

11 CHAIRPERSON KARNA: Can I open it up to

12 people on the phone for any comments or questions for

13 our panelists?

14 (No response.)

15 CHAIRPERSON KARNA: I am allowing for a

16 louder pregnant pause because apparently I was too

17 quick on the draw the last two panels.

18 Does anyone have views on steps custodians

19 could be taking beyond what has already been

20 highlighted that they are taking to help address some

21 of the challenges around volumes for the next couple of

22 phases?

23 (No response.)

1 CHAIRPERSON KARNA: All right. Well, you
2 guys did an excellent job, very thorough. Apparently
3 you have got it all under control. So thank you very
4 much for your time. And, with that, we are going to
5 shift to our next panel.
6 (Pause.)
7 CHAIRPERSON KARNA: Great. So now we are
8 going to shift to cross-jurisdictional issues in the
9 implementation of uncleared margin rules. And to
10 present on this topic, we have Tara Kruse, who is the
11 global head of infrastructure data and non-cleared
12 margin for ISDA.
13 MS. KRUSE: Thank you, Angie. Thank you to
14 Commissioner Stump, to the chairman, to the other
15 commissioners, and the GMAC Committee for having me
16 today to speak on cross-jurisdictional issues with
17 respect to the margin requirements.
18 Although global regulators have based their
19 margin requirements on the BCBS-IOSCO framework, there
20 are still differences that are causing challenges for
21 market participants who are subject to requirements in
22 multiple jurisdictions. In some cases, those
23 variations are based on the party scope or the product

1 scope subject to that regulator’s oversight. But,
2 nonetheless, that can cause complexity issues, cost
3 issues, and level playing field issues for market
4 participants. So let’s look at a few of these today.
5 First off, let’s talk about AANA calculation.
6 This has been brought up, but here are some of the
7 differences that we are seeing in this world. There
8 are differences in methodology timing for the
9 calculation period as well as applicable compliance
10 dates. In the U.S. and Brazil, the average aggregate
11 notional amount is based on a daily average of the
12 gross amount of the derivatives over the calc period;
13 whereas, the rest of the globe uses only the month and
14 total. So 3 observations, as opposed to 64
15 observations that were just required in the AANA calc
16 period for the U.S. for phase 5 that just completed.
17 In terms of the calc period itself, following
18 the phase-in period, the U.S. moves to a June-to-August
19 material swaps exposure calc period; whereas, the rest
20 of the globe stays with March to May. This means
21 parties have to run two separate AANA calc periods and
22 two separate periods of notification to their
23 counterparties in the event they have a change in their

1 status. That is especially challenging in cases, as
2 was pointed out earlier, for separately managed
3 accounts, where it may be difficult to aggregate the
4 necessary information.
5 Compliance dates as well, finally, following
6 the phase-in period, the U.S. and the E.U. moved to a
7 calendar year compliance cycle while the rest of the
8 globe stays on a September-to-August cycle. These
9 bifurcated dates create a lot of complexity. You can
10 see here is the calendar through January of 2023 if you
11 take into consideration all of the different AANA calc
12 and compliance date periods. If these dates were
13 aligned, it is much more simple.
14 Product scope. Differences in product scope
15 add costs and complexity to cross-border compliance as
16 firms have to implement mechanisms to identify
17 jurisdictional application and tag this on a trade-by-
18 trade basis. Most parties use a higher-of method to
19 calculate a separate initial margin calculation for
20 each jurisdiction and then settle the higher-of amount,
21 but in some jurisdictions, like the E.U. and Japan,
22 parties are allowed to use what we would refer to as a
23 broad product set, meaning you can include products

1 that are subject to non-cleared requirements in any
2 jurisdiction in your calculation.
3 Just to point out a couple of the differences
4 that are highlighted here on this slide, the E.U. is an
5 outlier for VM for physically settled FX swaps and
6 forwards. We do expect them to resolve that in an
7 upcoming amended regulatory technical standard.
8 Also, the other one getting a lot of
9 attention these days are equity options out of scope in
10 the U.S. That is not the case in some other
11 jurisdictions. The E.U., Hong Kong, Singapore, and
12 Korea all have delayed application of requirements to
13 equity options at this point, but those expire in early
14 next year. And many market participants are concerned
15 about the impact of that, especially in terms of a
16 level playing field between the U.S. and the E.U.
17 Settlement timing. The U.S. is most
18 restrictive in terms of settlement timing with its T+1
19 requirement. This can be particularly problematic for
20 counterparties trading between Asia and the U.S. It
21 prevents parties from settling using some collateral
22 that may take longer than T+1 to settle. And it is
23 expected to be more problematic as we move into the

1 final phases, where parties might be more likely to use
2 the third party custodial structures. And it may take
3 more time to do the settlements.
4 Eligible collateral. So when we have
5 multiple jurisdictions involved, the parties have to
6 agree an eligible collateral schedule that reflects the
7 intersection of the collateral that is allowed in each
8 of the relevant jurisdictions. This does create some
9 restrictions on what is allowed to be used. The
10 example that has been highlighted over and over today
11 is money market funds. We do expect that because of
12 the T+1 settlement required in the U.S., because of the
13 U.S.'s requirement to reinvest cash that is used as
14 collateral, and because of the use of more third-party
15 custodians in the final phases, parties will want to
16 use money market funds more. Unfortunately, there is a
17 direct conflict in the rules between the U.S. and the
18 E.U. in terms of the conditions for money market funds,
19 repos and reverse repos are allowed to be used in the
20 E.U. They are not allowed in the U.S., for instance.
21 In August, ISDA sent a letter on behalf of
22 six industry associations asking U.S. regulators to
23 expand the types of money market funds that can be used

1 as collateral, including allowing use of non-U.S. money
2 market funds. An equivalence determination from the
3 USPRs and respective E.U. rules would also help
4 mitigate the situation.
5 Inter-affiliate IM. Currently, the USPRs are
6 the only jurisdiction that requires inter-affiliate
7 initial margin. That might change, of course, as a
8 result of the rule that was put out earlier this week
9 or last week and approved by the FDIC and the OCC. The
10 E.U. also has an inter-group IM requirement. It is on
11 deferral until early next year. And they are currently
12 looking at potentially extending that or hopefully
13 eliminating it altogether.
14 IM model governance. This has been touched
15 on a bit today as well following the comments that
16 Rafael made and Wendy made on this topic. Just a
17 baseline a bit. So ISDA conducts robust and regular
18 testing of the ISDA SIMM model with global dealers in
19 order to prove that the model is regulatory-compliant.
20 And then, in addition, the dealers that use SIMM do
21 regular internal backtesting of the model to ensure
22 that the IM amounts meet or exceed the regulatory
23 requirements for all of their in-scope portfolios.

1 Despite these efforts, some jurisdictions
2 also impose individual model validation requirements
3 and backtesting requirements on smaller counterparties,
4 who might lack the resources, expertise, or
5 infrastructure to conduct such measures. That could
6 impact swap dealers in the U.S. that are in phases 5 or
7 6, but mostly the concern these days is about the E.U.
8 requirements that apply, of course, to the broad
9 spectrum of counterparties. And the concern is that
10 those counterparties won't be able to use a risk-
11 sensitive model, like the SIMM. Our estimates do show
12 that the bulk of the counterparties who will come into
13 scope in phase 5 and 6 or more counterparties from the
14 E.U. and U.K. will come into scope then from other
15 jurisdictions. We are engaged with E.U. regulators on
16 this matter to try to mitigate the impact.
17 And although this discussion is on cross-
18 jurisdictional initial margin issues, I would be remiss
19 if I did not raise potential issues within the U.S.
20 borders. The SEC, of course, did finalize its margin
21 requirements recently. And although they did come a
22 long way from their proposed rule to their final rule
23 in terms of aligning with CFTC and USPR requirements,

1 there are still some primary differences that are
2 likely to cause challenges for market participants.
3 First off, I will mention party scope. So
4 the SEC rules don't have an equivalent for the material
5 swaps exposure level or the financial end-user
6 definition or that they rely on a list of exemptions,
7 like a commercial end-user exemption. But this means
8 there might be smaller counterparties not caught by
9 U.S. rules already, who will be subject to SEC margin
10 requirements.
11 Also, security-based swap dealers are
12 required to collect IM but not post IM. And there is
13 no IM exchange between dealers. For some market
14 participants, this is a welcome divergence, but it does
15 create a good deal of complexity in terms of trying to
16 figure out for parties in the U.S. which transactions
17 are in scope between swaps and security-based swaps
18 when you have to post and when you have to collect.
19 One of my colleagues took a stab at trying to
20 figure out what that logic looked like. And he came up
21 with 32 variations that a swap dealer alone might have
22 to look at to figure out when they might need to post
23 or when might they need to collect for their swaps and

1 security-based swaps. And that is not even taking into
2 consideration MSPs.
3 Next up I will mention segregation. So under
4 the SEC rules, a party can elect third party
5 segregation, as we currently have, or omnibus
6 segregation or they can waive the segregation
7 requirement altogether. The existing suite of IM CSAs
8 is built on the third party segregation model. So we
9 would have to have new docs or new provisions for
10 separate treatment of transactions under the SEC. It
11 is not clear at this point how many counterparties will
12 be eligible to take advantage of this opportunity. If
13 they are subject to a third party segregation
14 requirement in any other jurisdiction, including under
15 USPR rules, then they may not be able to take advantage
16 of this.
17 Haircuts for collateral. The SEC has their
18 own standardized set of haircuts for collateral. And
19 they actually vary for standalone security-based swap
20 dealers versus broker-dealers. A security-based swap
21 dealer can elect to apply the CFTC's haircuts, but
22 broker-dealer security-based swap dealers have to use
23 the SEC's haircuts for equity security-based swaps. So

1 if a party is subject to the SEC, you might have to use
2 the more punitive haircuts if they are more punitive
3 than the other U.S. rules.
4 IM calculation. The SEC rules don't use the
5 BCBS-IOSCO regulatory schedule for calculating IM.
6 They don't use that same grid. Rather, they have
7 distinct methods for IM calculation that are specified
8 for each of broker-dealers and separate ones for
9 standalone security-based swap dealers and separate
10 ones for equity and separate ones for CDS. This would
11 make it very difficult for their counterparties to
12 replicate that initial margin amount to check the
13 amount that they are being required to post. A broker-
14 dealer can apply to use an IM model like SIMM but only
15 for its non-equity security-based swaps. A standalone
16 security-based swap dealer can apply to use an IM model
17 like SIMM for both equity and non-equity security-based
18 swaps.
19 Portfolio margining. Standalone security-
20 based swap dealers can use a quantitative model, like
21 the SIMM, to portfolio margin equity security-based
22 swaps and swaps subject to further coordination with
23 the CFTC. CFTC rules don't currently contemplate

1 portfolio margining, but this approach was acknowledged
2 in a staff letter from DSIO and DCR to ISDA back in
3 2016. So this is an area that we would look for the
4 agencies to collaborate around, although there are
5 potentially still challenges with being able to do this
6 since there are limitations on the SEC side in terms of
7 what can be portfolio margined, despite the fact that
8 swaps and security-based swaps are being margined
9 together on the USPR side.
10 As was mentioned earlier, the SEC does have
11 an alternative compliance mechanism. A standalone
12 security-based swap dealer can elect to comply with the
13 CFTC's margin rules for their security-based swaps
14 provided they are not clearing for clients and provided
15 their security-based swaps don't exceed the specified
16 margins. It is yet unclear how many security-based
17 swap dealers will be eligible for this alternative.
18 An effective way to mitigate the cross-
19 jurisdictional margin issues is by international
20 deference or even domestic deference, but to date,
21 substituted compliance is available in very limited
22 cases. I would certainly encourage U.S. and global
23 regulators to prioritize equivalence determinations to

1 help simplify this complex world of cross-border
2 margining.
3 CHAIRPERSON KARNA: Thank you very much, Ms.
4 Kruse, for taking an already complex topic and helping
5 distill some of the key issues that can be fruit for
6 further discussion.
7 So, on that, we have a lot of GMAC members
8 who have operations in multiple jurisdictions. So I am
9 interested in people's perspectives on what are some of
10 the most challenging aspects from your firms'
11 perspective with respect to some of these
12 jurisdictional differences? And, furthermore, are
13 there any suggestions you would have, either consistent
14 with what ISDA has already presented or any other
15 suggestions, to help mitigate some of those
16 differences? Ms. Guest?
17 MS. GUEST: Yes. I think one of the things
18 that we would appreciate the Commission to focus on is
19 the settlement timing. The T+1, 2, 3, 4, 5, promptly
20 differences are not only challenging because of the
21 fact that different jurisdictions have different
22 requirements, but also when you have operations in
23 multiple jurisdictions, you are running certain

1 operational processes at a particular time of day.
2 There are cutoffs for those processes. There are all
3 kinds of logistical things that happen operationally
4 within firms, let alone bringing the complexity of the
5 custodians and if you have instructions that have to be
6 passed and things. So I think the T+1 requirement is
7 one that I think a lot of folks would probably
8 appreciate the Commission taking another look at.
9 CHAIRPERSON KARNA: Thank you, Ms. Guest.
10 On the phone, do we have any comments or
11 questions, either for our panelists or on the general
12 topic of cross-border challenges and potential
13 solutions?
14 (No response.)
15 CHAIRPERSON KARNA: Mr. Yamada?
16 MR. YAMADA: Thank you.
17 I think that was an extremely illuminating
18 presentation on many of the different inconsistencies
19 and, frankly, some of the things that I guess from the
20 dealer perspective, you know, we consider many of the
21 operational perspectives but not necessarily see some
22 of the impacts on end-users. So it is quite
23 illuminating to see how complex and how diverse this

1 is.

2 I think, I mean, from our perspective here

3 and our mandate here on this panel, it definitely bears

4 additional scrutiny because, I mean, just the number of

5 line items that you identified, you can see that

6 implementation is just -- I mean, it is going to be a

7 practical nightmare. So perhaps, you know, in the

8 course of the implementation and the roadmaps and the

9 timelines, we should also attempt to, I guess, increase

10 that harmonization globally and, I guess, also perhaps

11 take a look at prioritizing, to Commissioner Quintenz's

12 original point, more of a risk-based approach. Where

13 are the real systemic risks associated with many of

14 these complexities and which ones are quite irrelevant

15 and just an operational burden? And perhaps that might

16 be something we could focus on.

17 CHAIRPERSON KARNA: Thank you.

18 Ms. Bradbury?

19 MS. BRADBURY: Tara, I wonder if you could

20 just talk a little bit more about how the SIMM model

21 was developed and the governance and the involvement of

22 actual regulators in that model since I think it is a

23 pretty central part of this whole risk reduction system

1 we have put in place.

2 MS. KRUSE: Yes, happy to. I mean, I think
3 when the rules were being developed and people knew
4 what the landscape was in terms of what the
5 requirements were going to be, it became clear fairly
6 quickly that having multiple models or each dealer
7 having a different model, each counterparty using a
8 different model was just not tenable. Parties would
9 not be able to replicate the calculations that parties
10 were making because, of course, you are calculating the
11 amount that you are asking your party to post to you.
12 So how can they replicate that? How can they dispute
13 it?

14 So the industry came together to say it is
15 just not possible. We can't support many, many
16 different models. There is a huge value to having a
17 standardized model that we can all apply where it is
18 transparent. So I can calculate what I am posting to
19 you. I can calculate what I am asking, you know, you
20 to post to me. And we have that check in place. It
21 needs to be transparent.

22 Also, there is clearly a lot of work involved
23 in developing a model and maintaining a model. And to

1 have many, many parties having to replicate this over
2 and over again just simply isn't supported. So the
3 industry came together and came to ISDA and worked
4 together through the thought leadership of many of the
5 major industry participants to pull together ideas in
6 terms of what would be a workable solution for
7 calculating initial margin and an approach that would
8 balance having appropriate risk coverage that aligned
9 with the requirements but also not having the model be
10 too complex because it was important that people could
11 calculate quickly and that it could be approachable for
12 a variety of market participants. Once you got it set
13 up and you have the inputs, you can actually calculate
14 SIMM on a spreadsheet, right? As was mentioned
15 earlier, it is really the setup and the data that you
16 need that is the most complex part, not the model
17 itself. And to date, yes. I mean, the model is being
18 used across the board by almost all market participants
19 that have phased in. And it is appropriately
20 conservative to meet global regulatory requirements.
21 There was broad engagement with regulators, especially
22 in the E.U. and the U.S. and Japan, early on in terms
23 of the development of the SIMM to make sure that it was

1 going to be satisfactory to regulators. And we have
2 continued engagement with regulators as we monitor
3 quarterly the performance of SIMM and send out reports
4 across the globe to assure everyone that, in fact, the
5 model continues to perform as expected.
6 CHAIRPERSON KARNA: Thank you.
7 Ms. Belich?
8 MS. BELICH: Thank you.
9 I echo the comments that were made earlier
10 about how well this kind of lays out the complexities,
11 even at a high level, because I think within this, as I
12 am sure most other banks in this panel would kind of
13 agree that there are kind of deep, deep roots from each
14 of these issues beyond just what we see here.
15 Kind of turning to the product scope, I am
16 just wondering if you can offer a little bit more kind
17 of detail around -- for example, you mentioned equity
18 derivatives. And I know that from a dealer’s
19 perspective, you know, one of the things that the
20 industry sees a lot is not only the regulatory
21 arbitrage that you had referred to earlier and I know
22 was discussed in the earlier panels but also how that
23 kind of leads to ongoing issues, maybe even more from a

1 dispute resolution perspective. So, for example, if
2 there are issues where, you know, dealers are even
3 taking a different product interpretation for in the
4 equity space under EMIR, right, how that leads to kind
5 of ongoing issues that still remain unresolved from an
6 ISDA perspective.
7 MS. KRUSE: Yes. We certainly do see that
8 come up. When we seek information from parties about
9 disputes that they have in relation to their IM
10 amounts, what they indicate primarily is that there is
11 not an issue with the calculation of the initial margin
12 amount. Not so often, it is an issue about the inputs.
13 It is often about the portfolio. It is about the
14 trades that each party has put into the portfolio to do
15 their IM calculation. Those are the differences that
16 they see and have to resolve in order to get to the
17 right IM calculation. And so sometimes that is a
18 determination. Is it a swap? Is it a security-based
19 swap? There seem to be areas where there is a lot of
20 consistency. Is it an equity option? Is it not? I
21 mean, these are fundamental issues that do come up.
22 As part of our SIMM governance forum that
23 helps do the maintenance of the SIMM model, parties do

1 sometimes raise these issues about product scope. And
2 we try to look at it and provide guidance where
3 appropriate, but at the end of the day, there are
4 inconsistencies.
5 We do encourage people to prepare ahead of
6 time and test with their counterparties before they go
7 live because that is often a good opportunity to
8 identify where you might be identifying a product
9 differently than your counterparty and, therefore,
10 would bring it into scope differently than they would
11 when you begin to calculate your initial margin.
12 CHAIRPERSON KARNA: Any other questions for
13 Ms. Kruse or any other comments around cross-border
14 complexities and the impacts on business?
15 (No response.)
16 CHAIRPERSON KARNA: On the phone, anything
17 else?
18 (No response.)
19 CHAIRPERSON KARNA: Great. We will now take
20 a break for lunch. Thank you.
21 (A luncheon recess was taken at 12:15 p.m.)
22
23

1 A F T E R N O O N S E S S I O N

2 (1:47 p.m.)

3 CHAIRPERSON KARNA: Great. So before we get
4 to our last panel, I just wanted to raise an additional
5 piece of business, really, to follow up from the very
6 helpful and detailed panels we had this morning on our
7 first deep-dive topic, which was margin. It seemed
8 like there was a great deal of wonderful insights from
9 a number of our panelists as well as open issues for
10 consideration that would be very helpful to discuss in
11 a smaller subcommittee of the GMAC if there is an
12 appetite to set that up. And the idea would be to set
13 up, the Commission would set up, a subcommittee of the
14 GMAC, which could consist of both members of the GMAC
15 and nonmembers, to really take a deeper dive and look
16 at some of the issues in advance of phase 5 and phase 6
17 that the industry is grappling with and help formulate
18 some recommendations to give to the Commission in a
19 more formalized way than we have been able to do and
20 dig deeper than we were able to do this morning as well
21 as in the prior GMAC.

22 So I know that Commissioner Stump is in favor
23 of at least me raising this topic with you. So I open

1 it up for discussion if people think that that would be
2 a worthy subcommittee to recommend to the CFTC to set
3 up. Any thoughts? Mr. Yamada?
4 MR. YAMADA: I would most certainly be
5 supportive of that and would love to participate.
6 CHAIRPERSON KARNA: Any other thoughts on the
7 idea? Ms. VedBrat?
8 MS. VedBRAT: Yes. I would be supportive,
9 too. My understanding is that we would want to do this
10 relatively soon, right?
11 CHAIRPERSON KARNA: Ideally, the idea would
12 be to capitalize on the momentum from this morning's
13 discussions as well as previous discussions,
14 suggestions already raised to the CFTC, and get a group
15 of industry participants to quickly act upon some of
16 those recommendations to formalize them for the CFTC.
17 If there is no further discussion, would
18 anyone like to make a motion?
19 MS. GUEST: Thank you.
20 Yes. So I would move that the GMAC recommend
21 to the Commission that it consider creating a
22 subcommittee on uncleared margin or margin for
23 uncleared swaps.

1 CHAIRPERSON KARNA: Wonderful. Any second to
2 that motion? Ms. Bradbury?
3 MS. BRADBURY: Yes. I would second that
4 motion.
5 CHAIRPERSON KARNA: Excellent. All in favor,
6 please raise your hand.
7 (Show of hands.)
8 CHAIRPERSON KARNA: We have a unanimous
9 approval of that motion. Thank you very much.
10 And, with that, we will go on to our next
11 panel and our next topic. So our final panel today is
12 going to be focused on EMIR 2.2 and the ESMA
13 consultation. We have three presenters on this topic:
14 Sean Downey, the executive director of global clearing
15 and risk policy for the CME Group; Carolyn Van den
16 Daelen, the head of regulation and compliance for ICE
17 Clear Europe; and Jackie Mesa, chief operating officer
18 and senior vice president of global policy for the FIA.
19 I turn it over to you.
20 MR. DOWNEY: Thank you.
21 I will lead off with some background on the
22 EMIR 2.2 and the ESMA consultations, but first I wanted
23 to thank Commissioner Stump, the rest of the

1 commissioners of the CFTC and CFTC staff; in
2 particular, Andrée Goldsmith, for setting all of us up.
3 So, with no further ado, I will start with a
4 little bit of background. The origination of the topic
5 that we are discussing right now really started in June
6 of 2016, when the U.K. referendum occurred and the U.K.
7 voted to leave the European Union. I will note that
8 that vote occurred about 10 days after most U.S. CCPs
9 received recognition under the previous European
10 regime. And in July of 2017, about a year later, the
11 original European Commission proposal was released to
12 revamp and overhaul the regime for non-E.U. CCPs in
13 Europe, at the time with a focus on European monetary
14 policy and the clearing of the euro.
15 Following the 2017 release, over the next 2
16 years, the European Commission, European Council and
17 European Parliament negotiated the text of EMIR 2.2 and
18 reached a political agreement in March of 2019. And we
19 expect that it would be published in the Official
20 Journal by the end of 2019, so in the next few months.
21 Following the agreement on EMIR 2.2, the next
22 step is to issue a delegated act with regulatory texts
23 covering three topics. Those topics include tiering,

1 which is effectively the assessment of a non-E.U. CCP
2 to determine whether it is systemically important;
3 comparable compliance, which focuses on the ability of
4 a systemically important CCP to rely on its home
5 jurisdiction's regulations to "meet the European
6 requirements"; and, finally, fees, which cover the fees
7 necessary and proposed by the European Commission to
8 cover the expansion of ESMA to oversee non-E.U. CCPs.
9 There was a consultation that ESMA issued on these
10 three topics in May of 2019, which closed in July of
11 2019. And I think each of the panelists will be
12 covering some of the responses to those consultations.
13 To go into a little bit more detail, the
14 result of the tiering analysis, which will be finalized
15 by the European Commission we expect in early 2020,
16 will be putting non-E.U. CCPs in two buckets. One
17 bucket is Tier 1, which will effectively be treatment
18 similar to what non-E.U. CCPs have today in Europe with
19 some additional data sharing; and Tier 2, which
20 features the direct application of European regulations
21 to a non-E.U. CCP that is deemed systemically
22 important.
23 From a criteria perspective, EMIR 2.2 created

1 five criteria for the evaluation of whether a non-E.U.
2 CCP is systemically important in Europe. As you can
3 see, it focuses on, in most cases, the impact of that
4 non-E.U. CCP in Europe ranging from the potential
5 impact of a failure, the extent of its clearing
6 European-denominated products, European clearing member
7 participation in its markets, and its relationships
8 with E.U. financial institutions. That EMIR 2.2
9 criteria is what ESMA then took in its consultations,
10 which we will go into more detail in shortly, and
11 expanded upon it to propose more detailed requirements
12 to evaluate whether or not a CCP is systemically
13 important in Europe. And that is what constitutes the
14 tiering consultation. As I mentioned before, there are
15 two other consultations that we will address, but
16 primarily it will be the tiering and the comparable
17 compliance ESMA consultations.
18 With that, I will turn it over to Carolyn to
19 discuss the next slide in more detail.
20 MS. VAN DEN DAELEN: Sure. Thank you.
21 So, again, my name is Carolyn, and I am the
22 head of regulation and compliance for ICE Clear Europe.
23 ICE Clear Europe is just one of ICE's six

1 geographically diverse clearinghouses. And we serve
2 global markets and customers in North America, Europe,
3 and Asia. Each of these clearinghouses is subject to
4 the direct oversight of our local domestic regulators,
5 often in close coordination with and communication with
6 other regulatory authorities with vested interests.
7 And we are also reflective of the G20 reforms and the
8 CPMI-IOSCO principles.
9 Just by way of background, ICE Clear Europe,
10 which clears markets located in the U.S., the U.K.,
11 Europe, as well as OTC credit grades, is directly
12 regulated by the CFTC, the SEC, the Bank of England,
13 and the College of National Competent Authorities in
14 Europe, which is already an EMIR construct. And so
15 with the tiering proposal and the binding level 2 text
16 that will come into force in the coming weeks and
17 months, we are now starting to explore how ESMA will
18 deem a CCP either Tier 1 or Tier 2. So on this slide
19 before you, you have the five categories that Sean
20 mentioned. Those are in the green boxes at the top.
21 And then underneath that, you can see that there is a
22 variety of text, which has 14 different indicators that
23 ESMA has drafted in their consultation paper, which are

1 the items that ESMA will assess when they are examining
2 a CCP to be either Tier 1 or Tier 2.
3 I think it is important to note that the
4 determination of the tier of a CCP has important legal
5 consequences as well. Once you are deemed Tier 1 or
6 Tier 2, then you are only legally allowed to provide
7 clearing services into Europe. Without that authority,
8 it is illegal for a CCP to provide access to its
9 clearinghouse to European clearing members and European
10 end clients. And so I think when we are looking at
11 these criteria, it is very important to think not only
12 how does it impact the clearinghouse but how it impacts
13 the clearing members and their European clients.
14 So our intention is not to walk through the
15 14 indicators, but I think Sean and I and Jackie would
16 like to just highlight certain of those. So the first
17 indicator that I would like to highlight is indicator
18 1, "Assess the non-E.U. CCP's ownership, business, and
19 corporate structure." What ICE identified with this
20 indicator is a general theme that we see through some
21 of the other indicators, which is a misunderstanding or
22 a lack of a nexus as to how this indicator actually
23 determines a CCP's systemic impact on E.U. financial

1 stability. In fact, when we look at this indicator, a
2 CCP's ownership, business, or corporate structure is
3 more something that a CCP would provide information to
4 its regulator once it is approved or authorized to
5 provide services and on a supervisory basis. But we
6 struggle to see how ownership and business and
7 corporate structure impacts a systemic impact on E.U.
8 financial stability.
9 MS. MESA: I am just going to highlight a few
10 of the broader concerns. FIA filed a letter to ESMA
11 per their consultation. And I wanted to highlight a
12 few over-arching themes, rather than getting into the
13 detail.
14 Something Carolyn just said is each indicator
15 should have a nexus to the systemic risk of the E.U. or
16 an E.U. member state. If you do look through each
17 indicator, you may struggle to find the nexus to
18 systemic risk.
19 Additionally, the indicators are fairly
20 broad. I think there is a couple of issues with the
21 broadness of the indicators. One is it leaves a lot of
22 latitude to the assessor, so ESMA. That may be okay,
23 but then you are going to constantly be questioning,

1 are we being assessed similarly to our competitors or
2 to the next CCP? So I think the indicators being too
3 broad may lead to some questions about fairness.
4 Additionally, I think the broad nature of the
5 indicators lacks legal certainty for the CCPs being
6 assessed. So you would definitely want CCPs being
7 assessed to be able to determine ahead of time whether
8 they may or may not be in the category of Tier 2. And
9 I think if you look across the indicators, you probably
10 would have no idea how you would be assessed based on
11 the broad range of indicators.
12 We made a few suggestions. One of them is
13 probably tier -- sorry to use that word -- or
14 prioritize the indicators, so which ones are really
15 important and which ones are less important. Tier
16 level 1 does not indicate that they can't do that
17 prioritization. So we suggest they do.
18 Additionally, beyond prioritization, they
19 should also consider using examples. So I think if you
20 look at ownership, what are you concerned about on
21 ownership? And giving some examples would help the
22 industry in making their own assessments.
23 MR. DOWNEY: Thank you.

1 I think I will just expand a little bit on
2 both of the prior comments. It was noted, for example,
3 in indicator 1 that non-E.U. CCP's ownership, business,
4 and corporate structure is not necessarily relevant to
5 whether it is systemic in the E.U. We certainly agree
6 with that and would expand on it. I was sitting before
7 I was about to present on this panel, and I went
8 through each of the indicators. And I underlined all
9 of the language that we thought didn't have an E.U.
10 nexus and wasn't a true test of systemic importance in
11 Europe. And I ended up underlining parts of every
12 single indicator. So I am not going to go through all
13 of them. However, you can continue on that path if you
14 look. For example, even at indicator 2, it starts off
15 with an E.U. nexus discussing the clearing obligation
16 in the E.U. currency denomination, but then it talks
17 about the complexity, price volatility, and average
18 maturity of the instruments cleared. Again, if that
19 E.U. nexus doesn't exist as a predicate, the fact that
20 there is complexity, price volatility, or that maturity
21 of those instruments isn't really relevant to
22 determining wither a non-E.U. CCP is systemic in
23 Europe.

1 The same thing would be true if you look at
2 indicator 5, the risk profile of a non-E.U. CCP;
3 transparency, indicator 4. You could go on and on, but
4 I think the primary issue that we are identifying is if
5 you look at the EMIR 2.2 text, we interpreted it to
6 suggest and require an evaluation of non-E.U. CCPs,
7 keeping the impact of those non-E.U. CCPs on Europe in
8 mind. And, unfortunately, the ESMA consultations from
9 our perspective have not followed that approach and
10 have created an expansive, somewhat vague set of
11 indicators for the evaluation of systemic importance in
12 Europe. And we think that that is not good for non-
13 E.U. CCPs, for the global markets, or for our
14 participants. And so we have some concerns about the
15 tiering consultation from that perspective.
16 MS. VAN DEN DAELEN: Just building on those
17 comments, it is important to note that in the level 1
18 text, which is binding law today, there is an
19 obligation for ESMA to make the criteria objective and
20 transparent. And, as Sean and Jackie noted, when you
21 look at this criteria and the indicators under each
22 category, that objectivity and transparency doesn’t
23 always exist. So for indicator 6, where it says,

1 “Assess the non-E.U. CCP’s margin, default fund
2 contributions, and eligible collateral,” we would agree
3 that that is important for ESMA to look at when they
4 are assessing the tier of a particular CCP. However,
5 without that objectivity and that transparency into
6 what they are actually looking at in terms of margin
7 and default fund contributions, it is difficult to
8 assess how they will apply consistently and
9 consistently tier the different CCPs who have different
10 default fund contribution setups and margin
11 requirements.
12 MR. DOWNEY: And if I can just add one point
13 on that particular indicator. And that goes to the
14 previous comments about E.U. nexus that we have all
15 made. There is no tying of the variation margin, the
16 initial margin, the default fund, to the E.U. In this
17 indicator. It looks at it from an aggregate
18 perspective. And from our view and I think from
19 others’ view, the fact that you have a certain amount
20 of initial margin or have certain variation flows in
21 U.S. dollar or some other currency that doesn’t
22 necessarily have an E.U. nexus isn’t really relevant to
23 the evaluation of systemic importance. So, once again,

1 for this indicator 6, we think it should be tied to
2 this point about E.U. nexus.
3 MS. VAN DEN DAELEN: And, finally, Jackie
4 made a good point about using numerical tests or
5 quantitative assessments. And I think that what is
6 missing in some of these indicators is relativity and
7 not looking at numbers in the absolute. So just for
8 example, the total amount of initial margin denominated
9 in Euro--so having that European nexus--held across all
10 six of the ICE CCPs is just over 19 billion euro, which
11 is only .12 percent of the total E.U. economy. So it
12 just shows you you can look at a number as big as 19
13 billion, but in the scale of the E.U. economy, that is
14 a very small percentage.
15 MS. MESA: The next proposal was on
16 comparable compliance. This is really how the E.U.
17 will judge whether they rely on home country regulation
18 or EMIR requirements will apply.
19 Under the ESMA's proposal, the comparable
20 compliance assessment will be conducted on a CCP level
21 that is different than the current equivalence
22 assessment, which is done on jurisdictional level. It
23 is requirement by requirement, a mapping of the non-

1 E.U. requirement to the corresponding EMIR requirement.
2 The supervisory approach on how ESMA would actually
3 eventually supervise the third country CCP as Tier 2 is
4 still a little bit vague and remains unclear. But
5 there are core requirements they put forward in the
6 consultation response and non-core requirements.
7 The list of core requirements gets a
8 different kind of assessment. It will be considered
9 comparable when they are always equal or at least as
10 strict or conservative as the corresponding EMIR core
11 requirement. And if it is not the case, then EMIR will
12 apply.
13 So if it is quantitative, so something that,
14 of course, requires a number, it has to be as strict as
15 the EMIR requirement. And if it is a qualitative
16 assessment, it has to be as conservative as the EMIR
17 requirement. For non-core requirements, it has to be
18 similar to the corresponding EMIR non-core requirements
19 to substantially achieve the respective regulatory
20 objectives of EMIR.
21 Comparable compliance, they say even if the
22 requirement by requirement doesn't match the EMIR
23 requirement, they would then look at whether the

1 requirement achieves the regulatory objectives of the
2 corresponding EMIR requirements and effectively
3 reflects the union's interest as a whole. I think that
4 I have used the exact words because I think that is
5 left up to what you think it might mean. I take that
6 to mean objective-based outcomes, but it is a little
7 hard to reconcile how they would do a requirement-by-
8 requirement assessment and then at the end do an
9 overall objective requirement. So I think you are one
10 or the other. And to me, it is hard to have both in
11 the same proposal.
12 MS. VAN DEN DAELEN: Sure. So just to expand
13 upon the second line on this slide, which talks about
14 the lack of clarity on the supervisory approach, in the
15 consultation papers, it is noted that ESMA would
16 presumably limit its supervisory authority to only
17 those EMIR requirements for which ESMA cannot find a
18 comparable requirement in the third country regime.
19 However, two paragraphs after that, there is a
20 statement by ESMA that, regardless of the comparable
21 compliance assessment, ESMA retains full supervisory
22 powers over a Tier 2 CCP.
23 So when a CCP is looking to apply to ESMA and

1 to have a tiering and comparable compliance assessment,
2 that is a cost that we have to analyze. And if there
3 is a chance that ESMA will become a full supervisory
4 authority, then that is something we have to add into
5 the question as to whether we want to offer our
6 services into Europe.
7 MR. DOWNEY: And just to add one more point
8 on this slide -- and I think it is an important one
9 that Jackie touched on -- the concept of comparable
10 compliance, as she mentioned, is one of outcomes basis.
11 It is one of evaluation of a regulatory regime to
12 determine whether it is comparable.
13 As drafted right now -- and agree that the
14 text is not entirely clear -- the idea that you would
15 always have to be equal to or at least as strict or
16 conservative as a corresponding EMIR requirement and if
17 you are not, apply EMIR as a floor effectively
18 undermines or eliminates the whole concept of
19 comparable compliance and the reason being that if you
20 think about it from a quantitative perspective, you
21 could have a regime in two different jurisdictions that
22 would have slight differences and are equivalent
23 overall or one is even more conservative in most cases.

1 But in some small cases, that regime is not as
2 conservative. And, as a result, you are applying the
3 EMIR requirement either directly or as a floor, no
4 matter what, because it is impossible, effectively, to
5 always be at least as strict or conservative if you
6 have two different requirements in two different
7 regimes. So, effectively, what that language does is
8 it eliminates the concept of comparable compliance as
9 currently drafted.
10 MS. VAN DEN DAELEN: And I will just add that
11 hearing what Sean just said is what are our concerns
12 about having a regime of this nature. And it is really
13 we don't see how it can't cause anything but
14 contradictory requirements, duplicative supervision,
15 and a conflict between multiple CCP regulators during a
16 time of crisis. And it is these negative consequences
17 that will ultimately lead to market fragmentation and,
18 thus, real economic harm. This fragmentation could
19 lead to higher costs for commercial firms for financial
20 institutions and for their customers. And they may
21 also limit the jurisdictions that CCPs choose to
22 operate in, thus reducing the access to important
23 markets for clearing members and the clients that they

1 currently benefit from. And ultimately what does this
2 result in? Again, it is a decrease in liquidity that
3 is needed for the well-functioning and safe markets
4 that we have today.
5 MS. MESA: Just to finish this up with the
6 timeline, currently EMIR 2.2 actually can't become
7 applicable until these requirements or regulatory
8 requirements level 2 are complete. Level 1, which is
9 the legislation, is not yet published in the official
10 journal, which it has to be before level 2 is then
11 issued. We expect that to come before the end of the
12 year.
13 Once that is done, ESMA will issue its
14 technical advice, which is what we are consulting on
15 right now, to the European Commission on EMIR 2.2. We
16 think that will -- the three of us, by the way, in
17 creating this timeline not only looked at what was in
18 the consultation and what has been said publicly but
19 the information that we have been gathering. So this
20 is our own, a little bit of our own, intel.
21 We think that ESMA probably will issue
22 technical advice again before the end of the year right
23 after that is published in the official journal. Then

1 what has to happen is the European Commission issues a
2 delegated act. And that is sort of the final step for
3 these level 2 regulations. And the delegated act
4 really is what will govern. They have to allow three
5 months for the European Parliament or the European
6 Council to object under what is called the better
7 regulation agenda. It is a public sort of
8 consultation, but it is really for the political bodies
9 to weigh in. And that will probably happen end of this
10 year, early next year.
11 And then determinations will start happening
12 for non-E.U. CCPs. We think this whole process at that
13 point could take 18 months before EMIR requirements
14 kick in for non-E.U. CCPs, again our best estimate,
15 made a guess on that.
16 Thank you.
17 MS. VAN DEN DAELEN: It is hard these days
18 working at a London-based institution to not mention
19 Brexit. So, even though Jackie just described the
20 relevant timelines for the world as it is today, our
21 world in the U.K. will change presumably come the 31st
22 of October. So operating under the assumption that
23 there is a no-deal situation -- and there could be a

1 deal that is made, but I do not have a crystal ball.
2 So I can't tell you that.
3 But operating under the assumption that there
4 is a no-deal Brexit on the 31st of October, last year,
5 the European Commission in conjunction with ESMA
6 granted temporary recognition for the U.K.-based CCPs,
7 including ICE Clear Europe. And, thus, we are allowed
8 to offer our services into Europe until the end of
9 March 2020. So there is a time gap between the end of
10 October and the end of March.
11 However, CCPs have notice periods for
12 termination in the event that it becomes illegal to
13 offer our services in Europe. ICE Clear Europe has a
14 30 business day notice of termination if we need to cut
15 off access to E.U. clearing members. Other
16 clearinghouses in London have as high as a 90 calendar
17 day termination period. So that really brings us to
18 around mid to end of December when the CCPs will need
19 to have clarity as to how we will operate once the
20 temporary recognition ends at the end of March 2020.
21 So, as you can see, that is a very short timeframe
22 between the end of October, when the no deal happens,
23 and then December, when we would potentially need to

1 terminate members.

2 And during that timeframe, there are a few
3 actions that can be taken. First, the European
4 Commission and ESMA can extend our recognition and give
5 us more time or, alternatively, we can walk through the
6 steps that Jackie just described and complete all of
7 these legislative steps by mid December, which I think
8 would be trying. But, nevertheless, that is something
9 that we hope can happen so that we have resolution and
10 our clearing members have certainty that they can
11 continue to use our services.

12 MR. DOWNEY: If I could just make one final
13 statement, just to flip that a little bit. There is an
14 assumption potentially that a no-deal Brexit could
15 occur October 31st. And Carolyn laid out the timeline
16 and implications there. Of course, on the other side
17 of the coin, there is the possibility that it is
18 extended for 12 months, 2 years, 3 years, whatever it
19 may be. In that case, the end result could potentially
20 be a situation where U.S. CCPs actually are the only
21 CCPs that are third country, at least from a size
22 perspective, as far as we can tell, that may be subject
23 to all of the steps that are laid out here. And so,

1 obviously, that is potentially a perverse result from
2 this new legislation and the ongoing political dialogue
3 to be the U.S. being caught in a position as being non-
4 E.U. and being subject to all of these new
5 requirements, but no other CCPs are. And so there are
6 kind of two potential timelines. I think both of them
7 are negative and they could impact different
8 jurisdictions differently.
9 CHAIRPERSON KARNA: Great. Thank you very
10 much.
11 Do we have any questions or comments for our
12 panelists, first in the room? Mr. Cutinho?
13 MR. CUTINHO: Thank you. Thank you very
14 much. I would like to thank our panelists for an
15 effective presentation.
16 I think I will be brief. There are two
17 things. One, we have expressed our concerns with
18 respect to the tiering. And if you look at the
19 indicators, I think I hope what comes through based on
20 what we see publicly is that ESMA's technical advice
21 deviates substantially from the spirit of the five
22 critical factors that determine tiering. So it is
23 important to see I think some level of certainty that

1 any rules that are put in place is, in fact, addressing
2 the nexus with the E.U., whether it be union currency
3 products or members based in E.U. and the exposures
4 that they have.
5 The second thing in the absence of that, we
6 are left to assume the worst. We are left to assume
7 that Tier 2 is what would arbitrarily be applied. And
8 in those circumstances, our concerns, as you have
9 noticed, as you have heard today from the panel, is
10 about comparable compliance. And it completely
11 disregards the equivalence agreement that is already in
12 place. And, in fact, it presents significant conflicts
13 and from our perspective -- I speak from a risk
14 management perspective -- significant conflicts.
15 We can take two simple cases. One is
16 individual segregation. So individual segregation
17 cannot be offered in the United States. Our account
18 standards are gross and legally segregated but
19 operationally comingled. The second issue that we have
20 is when we think of default management. So when we
21 have managed risk in the past, we have a strong history
22 of porting our non-defaulting clients to solvent FCMs.
23 And we have been able to do that because our

1 regulations in the U.S. have afforded us the
2 flexibility of moving our clients to a safe home in the
3 event that we face an issue like this.
4 Under European law, that is not possible. In
5 fact, it requires a clearinghouse to get the explicit
6 consent of each one of its clients and then
7 determination as to their end destination. And we
8 don't think that is a workable solution.
9 I have just referred to two issues where it
10 presents risks. You know, if we were to go further,
11 our concerns would be in the ability of a clearinghouse
12 to administer margins, so our ability to actually cover
13 our risk exposures when we see them.
14 You know, today under CFTC rules, we have a
15 great set of principles that apply not only to a
16 clearinghouse but to our clearing firms and in the way
17 our clearing firms administer margins when it comes to
18 their clients. All of that is under risk when Tier 2
19 regulations are applied.
20 CHAIRPERSON KARNA: Thank you.
21 Commissioner Quintenz?
22 COMMISSIONER QUINTENZ: Yes. Thank you.
23 I just had a quick question for Carolyn.

1 Given all of the steps that need to occur regulatorily
2 and legislatively and the window that you described
3 from a notice period perspective, do you believe it is
4 basically a certainty that there will need to be an
5 extension of the exemptions to operate in the E.U.?
6 MS. VAN DEN DAELEN: Thank you for your
7 question. Yes, I think it is highly likely that an
8 extension will be needed. And we have heard
9 recently -- and I know there have been press articles
10 about this -- that temporary recognition could be
11 extended, but the more time we have with that
12 knowledge, the better, not only for the clearinghouse
13 but also for the clearing members, because if we don't
14 know about this temporary recognition being extended
15 until later in the game, then clearing members may have
16 to take proactive steps to find another clearing house,
17 tell their end client. So, again, while I think that
18 it is likely and I am not certain, the more time, the
19 better.
20 MS. MESA: To just elaborate on what Carolyn
21 said, I think, even though a clearinghouse may issue a
22 notice 90 days before termination, which would actually
23 be in December -- so we are getting close -- clearing

1 members do start already. They don't wait for the
2 notice to show up at their doorstep, but they already
3 start planning alternatives. So the longer that goes
4 into November, really, the scarier that becomes.
5 CHAIRPERSON KARNA: Mr. Horkan?
6 MR. HORKAN: Thank you. And I really wanted
7 to offer my thanks for the Commission and commissioners
8 for taking this leadership role on cross-border
9 regulations and seeking coordination and cooperation.
10 So thank you very much.
11 On behalf of LCH, which operates
12 clearinghouses both in the E.U. and outside the E.U.,
13 it is clearly important. And as we operate the largest
14 interstate swap clearinghouse with clients' members in
15 60 jurisdictions, it is critical for us that we have
16 clarity on the rules and regulations in the
17 jurisdictions that we are part of, including being
18 directly registered with the CFTC for, proudly, the
19 last 18 years.
20 We submitted, our parent company, LSEG,
21 submitted, a comment letter on July 30th that really
22 talked about a couple of things that I think the panel
23 members articulated and outlined today: one, on the

1 tiering, really need clarity on the measurement against
2 these indicators as well as the prioritization for
3 them, as Carolyn said. And, secondly, on the
4 comparable, I believe it should be an outcome-based
5 approach, as opposed to a requirement-by-requirement
6 basis. So we would definitely like to seek clarity on
7 that and submitted the comment letter accordingly.
8 And to Commissioner Quintenz's question, we
9 do think an extension would be likely, would certainly
10 be welcomed, both by the market to avoid fragmentation,
11 to provide certainty to our members and clients that we
12 will continue to offer the service that we do. And to
13 date, we have seen no change in client behavior due to
14 that lack of knowledge, but we would ask all regulators
15 to eliminate any doubt.
16 CHAIRPERSON KARNA: Thank you.
17 Mr. Wetjen?
18 MR. WETJEN: Thanks, Angie.
19 I actually had a question for the panel.
20 What is your understanding of the role of the ECB or
21 the other European central banks at issue under EMIR
22 2.2?
23 MR. DOWNEY: Sure. I will take that. And

1 then feel free to expand. But the way that the EMIR
2 2.2 text is drafted, we understand that the ECB and
3 other central banks of issue would have powers in
4 emergency situations to express and require CCPs to
5 take certain action in regard to margins, liquidity
6 risk management, and other risk management tools. I
7 believe those powers are designed to last for six
8 months once they take action and then they have the
9 ability after those six months to extend as necessary.
10 We also understand -- and this is informally, rather
11 than within the text, that there is an expectation that
12 they would be able to weigh in and express their views
13 informally. And, in addition, they are I believe
14 observers but maybe not voting members of the
15 supervisory colleges that are going to be constructed
16 as part of this non-E.U. CCP construct for Tier 2 CCPs.
17 MS. VAN DEN DAELEN: Yes, that is correct.
18 That is my understanding as well. And, as Sean said,
19 the ECB does sit as a nonvoting member of our EMIR
20 college.
21 MR. WETJEN: So DTCC, we actually filed a
22 letter response to the tiering release too. We are a
23 clearing settlement service provider for the cash

1 markets, not derivatives markets, but one of the things
2 we raised in our comment letter response to the release
3 was this issue around the involvement of the central
4 banks, both over in Europe but as well as here in the
5 United States. I think part of the reason why we
6 raised it was just to be very open and honest about it.
7 I am not sure and haven't been convinced that
8 the central banking community in Europe has fully
9 thought through or those who are making this policy on
10 behalf of the central banking community in Europe have
11 fully thought this through. And I don't know whether
12 the European-based CCPs have a view on this, but if you
13 designate a non-E.U. CCP as Tier 2, then, necessarily,
14 you are going to involve not just the market regulators
15 but the central banks of two different countries. So,
16 in other words, we have obviously a number of SIDCOs
17 and SIFMAs here in the United States. And if the same
18 designation under EMIR 2.2 of Tier 2 status comes into
19 force in the E.U., then you have a very difficult
20 situation where you have central banks in their role as
21 supervisors but also the providers of emergency tools
22 and some kind of potential conflict about who is going
23 to do what. And that is a very, very difficult

1 position I think to put central banks in. So we all
2 have our relationships, fondness for the CFTC and the
3 other market regulators, but the central banks I think
4 are a really important part of the policy-making here.
5 And something that I am not -- I haven't been convinced
6 it has been thought about as much as it should be, not
7 so much on the part of the policy-makers here but
8 obviously those making the policies, in this case EMIR
9 2.2 over in Europe. So I just wanted to raise that
10 point here.
11 CHAIRPERSON KARNA: Thank you.
12 Ms. Bradbury, did you have a comment? Mr.
13 Yamada?
14 MR. YAMADA: Actually, I would echo those
15 comments. And, as we recently saw the joint CFTC-ESMA
16 letter I guess reestablishing a more collaborative and
17 cooperative attitude, I think that was heartening, but
18 the practical concern is, even if we do have some
19 clarity around what is very clearly not a clear set of
20 restrictions with respect to who is beholden to which
21 regimes, you can see a situation where in times of
22 stress, you have multiple different regulators and
23 central banks instituting somewhat conflicting policies

1 and, frankly, that resulting in an increase, rather
2 than a decrease, in systemic risk and a lot of
3 conclusion and more trapped capital and more
4 restrictions around resolving some of the issues we
5 face with counterparty liquidity and ending up tying us
6 up in knots a little bit. That is a little bit of a
7 concern from our perspective because we do see a little
8 bit of that happening. We have seen that in the past.
9 Again, to the extent that regulators are
10 cooperating, trying to rationalize, and not duplicating
11 efforts, that will do a lot to resolve that, but you
12 can quickly see a situation where, you know, that there
13 is gridlock because of multiple conflicting and not
14 ill-intentioned but just conflicting requirements from
15 different regulatory bodies, which, frankly, on a day-
16 to-day basis have not necessarily been relevant.
17 CHAIRPERSON KARNA: Thank you.
18 Mr. Muller?
19 MR. MULLER: Yes. My name is Erik Muller. I
20 am the CEO of Eurex Clearing. So I represent a CCP
21 that is based in the E.U. And I can echo some of the
22 points that were made here.
23 The CCPs operate global businesses. Our

1 markets are global, especially if you look into the
2 derivatives markets. It may not be as pronounced in
3 some of the other markets but certainly in the
4 derivatives markets, these are global in nature. So I
5 think it is really important that regulators globally
6 find a way on cooperating. There needs to be global
7 cooperation in managing these situations and the
8 oversight.
9 But I think it is also worth bearing in mind
10 that Europe, as far as I see it, has been probably
11 going at taking that, you know, to the extreme in terms
12 of granting equivalence. So if we as a European CCP
13 want to do business in the U.S., there is no question
14 you get a license for it.
15 And our experience with the CFTC has been a
16 good one. And I can confirm what was said previously
17 by LCH. So it is possible, even if there are different
18 roles that apply in Europe, to comply with other
19 regimes.
20 And I would like to counter some of the
21 potential impression you might get from regulations in
22 Europe from one of the previous speakers and as it
23 regards segregation models, et cetera. I think they

1 are just different. You know, you could make the case
2 that individual segregation is a stronger form of
3 segregation, especially if you look at the end clients.
4 Then is the model available in the U.S.? But there is
5 a background to it, and it is enshrined in the laws in
6 the U.S. and goes to the bankruptcy regimes that are
7 different in each of these countries.
8 So what I am trying to get at is there are
9 ways to navigate these differences. And we have to
10 find these ways. And I can only encourage both the
11 CFTC but also the E.U. Commission to find ways that
12 allow U.S. CCPs to continue to do business in Europe
13 but also the European CCPs to continue to do business
14 in the U.S., as these markets are truly global.
15 Thank you.
16 CHAIRPERSON KARNA: Thank you.
17 Ms. Mesa?
18 MS. MESA: I just want to pick up on a point
19 on the central bank point and the numerous hands, as
20 they say, on the steering wheel in a crisis, which can
21 cause greater systemic concern. I think what is
22 critical here is probably the MOU. If a CCP in a
23 certain jurisdiction is a Tier 2 CCP, then what will

1 happen is there will be a negotiation of an MOU. And
2 hopefully the regulator in that third country will
3 negotiate all of that ahead of time through an MOU.
4 The issue, though, is that what remains in
5 the law in level 1 of EMIR 2.2 is a potential for a
6 relocation. That remains. It is not being talked
7 about anymore because there have been assurances that
8 it won't be used. But I think, you know, cleverly, if
9 they are not perhaps getting what they need out of that
10 jurisdiction and that regulator, there is always the
11 threat that, "Well, we are just going to have to move
12 that clearing."
13 So, just to keep in the back of your minds
14 that I think this is a huge issue. Who does have
15 control in a crisis? And what does that look like? I
16 think it is really important for the industry to know
17 that ahead of time. Who are they going to answer to?
18 And speaking I guess on behalf of the
19 clearing member community, if they are getting
20 instructions, and particularly for the CCP, who might
21 be getting different calls for different things, for
22 the clearing member community, if they are getting
23 different calls to do different things from different

1 regulators, that just sounds like a nightmare. So
2 hopefully that gets worked out.
3 CHAIRPERSON KARNA: Mr. Downey?
4 MR. DOWNEY: Thank you.
5 I just wanted to pick up on a couple of
6 points as well. It is true that cooperation will be
7 important and that hopefully we can find ways where
8 different jurisdictions have different regulatory
9 requirements, that those can be reconciled and that
10 there is a path forward, but we should also remember
11 that each jurisdiction creates a regulatory regime
12 based on its local markets, its local legal
13 requirements and its local banking regulations. And so
14 an example of that would be we understand in Europe,
15 there has been a focus on the reinvestment of cash
16 collateral. And that is likely due to the historic
17 depositor protection in Europe.
18 In the U.S., our friends, both at the CFTC
19 and the Fed, have spent a lot more time focusing on
20 liquidity risk management. And so the approach to
21 collateral and approach to managing liquidity is
22 different in the two regulatory regimes. And we think
23 that is probably appropriate. And that is an example

1 of where you could get to a conflict and be in a
2 situation where you undermined stability because each
3 regime has taken an approach that is appropriate for
4 its overall legal regime and its regulatory regime.
5 And we think it is important to remember that and not
6 just assume that overlaying regulations on top of each
7 other will create a better result.
8 I also just wanted to point out from the
9 perspective of the CFTC, it is not true that if you are
10 a non-U.S. CCP, you necessarily have to register in the
11 entire exchange-traded derivatives market. You
12 actually do not need to register to offer foreign
13 futures to U.S. persons. So I just want to clarify
14 that point because I think it might have been lost in
15 the previous statement.
16 CHAIRPERSON KARNA: Mr. Cutinho?
17 MR. CUTINHO: Sean took some of my words
18 away. So I will have the second point.
19 Erik is right. You know, individual
20 segregation may not present financial risks to us, but
21 I was simply pointing out that it presents a legal risk
22 to us, so risks in general. People talk about legal
23 and financial.

1 CHAIRPERSON KARNA: Commissioner Stump?
2 COMMISSIONER STUMP: I actually was going to
3 ask a question about the offering of futures, but I
4 will take it a different direction. I would like for
5 the panel to maybe elaborate on the idea
6 that -- because I think oftentimes people in the public
7 are not quite as aware that the conversation over the
8 past few years has been almost exclusively centered on
9 OTC swaps. So the discussions we have had at the CFTC
10 with our counterparts in various jurisdictions have
11 been focused on OTC swaps. So to the extent that a
12 U.S.-based CFTC-registered DCO has been offering
13 futures in the commodity space for years, whether it is
14 crude oil or cotton, how might that be impacted should
15 a U.S. CCP be deemed Tier 2? And how might those
16 particular end-users and their clearing members be
17 impacted?
18 MR. DOWNEY: I can start with answering that
19 question. So the most obvious potential impact -- and
20 this, again, goes back to market structure and legal
21 and regulatory regime -- is the fact that in the U.S.,
22 primarily and I think exclusively, frankly, for
23 commodities, agriculture, and energy, there is an

1 ability to collateralize via letters of credit. So our
2 participants, for example, who are in the agricultural
3 space, have the ability to deposit letters of credit to
4 meet their collateral requirements with us because, for
5 whatever reason, they may not be natural holders of
6 U.S. Treasuries or U.S. dollar cash or whatever it may
7 be.
8 Our view is that that has developed over a
9 long time period. And it is very important, in
10 particular, for the U.S. agricultural markets. And so
11 that is probably the most obvious direct example of
12 potential impacts on U.S. markets and on U.S.
13 participants in the commodity space.
14 There are others. Any potential where you
15 have two different regulatory regimes increases costs
16 and makes access likely or potentially more expensive,
17 but I think the primary potential and the most clear
18 potential issue is in the letters of credit and the
19 ability to use that as collateral.
20 MS. VAN DEN DAELEN: Another potential
21 downstream effect on clearing members and clients could
22 just be that with the increased supervision from a new
23 regulator, longer lead times to implement new products

1 and new margin models are changes to products and
2 changes to margin models, which could potentially be
3 not what a clearing member wants if the margin model is
4 more efficient. So I think for that, it is something
5 you have to consider again when you want to add a new
6 regulator as a supervisor.
7 CHAIRPERSON KARNA: Another question for our
8 panel: what kind of feedback have you been getting
9 from your own clients around these proposals? We have
10 heard a lot about your perspectives and potential
11 impacts on your clients, but have you been engaging
12 with your clients? Have they been engaged on this
13 topic? And what kind of feedback have they given you?
14 MR. DOWNEY: So our engagement has primarily
15 been at the association level; so Jackie, for example,
16 so primarily FIA and ISDA. We have engaged with both
17 of those associations. And I think, as reflected in
18 the comments that they provided, I think there is a
19 recognition that regulatory cooperation, reciprocal
20 deference is important, both for us as a CCP but also
21 just more generally for the markets from a risk
22 perspective and from an efficiency perspective.
23 So I would say over the last months in

1 particular, as this European process has accelerated
2 towards a finish line, we have engaged. And our
3 understanding is that the same areas of concern, in
4 particular, with the ESMA consultations and the way
5 that they have been designed I think have arisen within
6 the market. But I defer to the market.
7 MS. MESA: Well, I think this is an
8 interesting point. When we ran the working group, our
9 working group had participation from clearing members,
10 end-users, and CCPs and exchanges. And the working
11 group actually was run out of Europe, not in the United
12 States. So the main participants in the work were
13 European. We had some Asian participants, some in the
14 United States, but the bulk were European. So the
15 views here in our FIA response are mainly those of
16 European participants.
17 And I think the reason that they reflect a
18 lot of the views you have heard up here is because when
19 they think about CCP regulation, they are also thinking
20 about clearing member, swap dealer, every other
21 regulation that could come down the line. And the
22 thought is we don't want duplicative regulation
23 anywhere, actually. If it is comparable, that should

1 be enough.

2 And so the view we took in our response was

3 how should the regime, regulatory regimes, work cross-

4 border in every single space? And that is the view in

5 our response.

6 CHAIRPERSON KARNA: Mr. Wetjen?

7 MR. WETJEN: I was just going to try to

8 respond to your question 2 from a different

9 perspective, that of the cash marketplace. You have

10 heard from other people, though, earlier today about

11 the appeal of having access to cleared products. And

12 that is true on the cash side, too.

13 And so, just for whatever it is worth, one of

14 the things that we have encountered or discovered is

15 that we are actually trying to expand access to

16 clearing as much as possible on the cash side. We are

17 doing that through a couple of different products. We

18 call them the sponsored member programs that we are

19 offering to different market participants. But so long

20 as this issue has not been fully resolved -- and we

21 have been focusing mainly on Europe and EMIR 2.2, but

22 there are active policy-makings in other jurisdictions

23 as well.

1 So wherever this issue is unresolved, what we
2 are finding is that either there is some reluctance on
3 the part of the CCP or there is some reluctance on the
4 part of these would-be members or sponsored members to
5 the clearinghouse in participating in the program
6 because no one quite knows what the regulatory impact
7 would be. But we had an internal panel last week at
8 our company, and we had a number of firms that are also
9 represented here today. And people are talking about
10 the importance of some of these products that I just
11 mentioned and having access to clearing, especially for
12 repo activity and securities financing and things of
13 that sort. And, again, it is just harder to do that.
14 In fact, one of the panelists last week at
15 our internal conference said, “We would like to see
16 these products moved to international participants. We
17 want more sponsored members coming in from outside the
18 U.S.” And, again, it is difficult to do that when
19 there is not certainty about what the regulatory and
20 legal impact of that would be.
21 CHAIRPERSON KARNA: Thank you.
22 Ms. Van Den Daelen?
23 MS. VAN DEN DAELEN: Thanks.

1 So just going back to what Commissioner Stump
2 alluded to is that the G20 was a commitment to review
3 and reform the rules around OTC derivatives. And when
4 EMIR went into effect, we saw that it included both OTC
5 and exchange-traded derivatives. The G20 also called
6 for global standards to be created and followed by
7 regulators and deference to local regulators. And what
8 we have heard as a concern from our members is that
9 EMIR 2.2 is again a further extension away from what
10 the G20 originally committed to.
11 CHAIRPERSON KARNA: Thank you.
12 Any comments or questions on the phone?
13 (No response.)
14 CHAIRPERSON KARNA: Wonderful. Thank you to
15 our final panelists of the day. I also want to just
16 take a moment before we go to some closing statements
17 to thank, first of all, Commissioner Stump for
18 gathering us all here today to talk about two very
19 critical issues in a detailed way and for also
20 initiating the idea of a subcommittee so we can
21 continue these discussions. I want to thank the
22 chairman, Commissioners Quintenz and Behnam for their
23 participation today, thank Andrée for her incredible

1 organizational skills in the midst of another big
2 project she is working on. And thanks to the other
3 staff who were very involved in helping to organize
4 this day. And, finally, thank you to our panelists for
5 participating and sharing your insights and also to our
6 GMAC members. Your perspectives are very, very much
7 appreciated by the Commission as they think through
8 these important issues.
9 Commissioner Stump?
10 COMMISSIONER STUMP: I will be very brief.
11 For anyone who has had to listen to me speak over the
12 past year, I am sure I am beginning to sound like a
13 broken record, but we all need to be reminded of how we
14 got here. We have regulated futures for a very long
15 time. We committed to reforms 10 years ago. And I
16 think each time we have this conversation, we need to
17 revisit what we committed to.
18 So in regards to this morning's conversation,
19 the reason that uncleared margin was initiated was to
20 ensure that the interconnectedness of institutions was
21 addressed outside of the clearing space in the event
22 that clearing was not appropriate or sought after and,
23 in addition, to encourage clearing.

1 With regard to clearinghouses and the utility
2 that they provide one of the key reforms was that we
3 would encourage more clearing, we would mandate more
4 clearing. We certainly do not want to set up a
5 situation where regulatory impediments make that more
6 challenging.
7 So, with that, I would like to thank Angie
8 very much for her tremendous leadership. She gets to
9 do all of the hard work when we have these meetings,
10 and I think I benefit from just listening. So thanks
11 so much, Angie. Thanks, Andrée. And thanks to all of
12 the members and the panelists.
13 MS. GOLDSMITH: Commissioner Quintenz, do you
14 have any closing remarks? Okay.
15 So thanks. I will echo everyone’s thanks.
16 And this meeting of the GMAC is now adjourned.
17 (Whereupon, at 2:48 p.m., the meeting was
18 adjourned.)
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