U.S. COMMODITY FUTURES TRADING COMMISSION (CFTC)

MARKET RISK ADVISORY COMMITTEE (MRAC)

Monday, September 9, 2019

3:01 p.m.

Commodity Futures Trading Commission - CFTC

Teleconference

MRAC Members in Attendance

Nadia Zakir, MRAC Chair, Pacific Investment Management Company LLC (PIMCO), Executive Vice President and Deputy General Counsel

B. Salman Banaei, Executive Director, Global Head of Clearance and Settlement, IHS Markit

Stephen Berger, Managing Director and Global Head of Government & Regulatory Policy, Citadel

Lee Betsill, Managing Director and Chief Risk Officer, CME Group

Isaac Chang, Managing Director and Co-Head of Trading, AQR Capital Management, LLC

Biswarup Chatterjee, Global Head of Electronic Trading & New Business Development, Credit Markets, Citigroup

Alicia Crighton, Chief Operating Officer, Prime Services, US Clearing, Goldman Sachs, Futures Industry Association (FIA)

Matthias Graulich, Chief Client Officer, Eurex Clearing AG

Frank Hayden, Vice President, Trading Compliance, Calpine Corporation

Lindsay Hopkins, Clearing House Counsel, Minneapolis Grain Exchange

Annette Hunter, Senior Vice President and Director of Accounting Operations, Federal Home & Loan Bank of Atlanta

Vincent B. Johnson, Head of Regulatory & Policy Affairs, BP Products North America

Demetri Karousos, Chief Risk Officer, Nodal Clear LLC, and Managing Director, Market Administration and Surveillance, Nodal Exchange LLC

Derek Kleinbauer, Global Head, Rates and Equity e-Trading, Bloomberg LP and Vice President, Bloomberg SEF LLC

Laura Klimpel, Managing Director, Clearing Agency Services at the Depository Trust & Clearing Corporation (DTCC)

Sebastian Koeling, Principal Traders Group, FIA

Kevin McClear, Chief Risk Officer, Intercontinental Exchange Inc.

Dennis McLaughlin, Group Chief Risk Officer, LCH Group

Craig Messinger, Senior Advisor, Virtu Financial

Dale Michaels, Executive Vice President, Financial Risk Management, The Options Clearing Corporation

John Murphy, Managing Director and Global Head of the Futures Division, Mizuho Americas, Commodity Markets Council

Christina Norland, Managing Director, Chatham Financial

Sam Priyadarshi, Principal, Head of Portfolio Risk and Derivatives, Vanguard

Jonathan Raiff, Senior Managing Director, Nomura Holdings, Inc.

Marnie Rosenberg, Managing Director and Global Head of Clearinghouse Risk & Strategy, JP Morgan

James Shanahan, Vice President, Financial Regulatory Compliance, CoBank ACB

Lisa Shemie, Associate General Counsel, Cboe’s Legal Division, Chief Legal Officer, FX and Cboe SEF

Dr. Betty Simkins, Head of Finance Department, Professor and Williams Companies Chair in Business, Oklahoma State University, Spears School of Business (Special Government Employee)

Tyson Slocum, Director, Energy Program, Public Citizen

Robert Steigerwald, Senior Policy Advisor, Financial Markets, Federal Reserve Bank of Chicago

Janine Tramontana, Senior Counsel and Vice President, Federal Reserve Bank of New York

Kristen Walters, Global Chief Operating Officer of Risk and Quantitative Analysis Group, BlackRock

Suzy White, Chief Risk Officer, Global Banking & Markets and Commercial Banking, Americas, HSBC

Rana Yared, Managing Director Principal Strategic Investments Team, Securities Division, Goldman Sachs

Scott Zucker, Chief Administrative Officer, Tradeweb

Speakers in Attendance

Thomas Wipf, MRAC Interest Rate Benchmark Reform Subcommittee (Subcommittee) Chair and Vice Chairman of

Institutional Securities, Morgan Stanley

Ann Battle, Leader of the Subcommittee Disclosure Working Group and Assistant General Counsel, International Swaps and Derivatives Association (ISDA)

Dennis McLaughlin, MRAC Member/Subcommittee Member and Group Chief Risk Officer, LCH Group

Agha Mirza, Subcommittee Member, Managing Director and Global Head of Interest Rate Products, CME Group

CFTC Commissioners and Staff in Attendance

Rostin Behnam, Commissioner, MRAC Sponsor

Dan Berkovitz, Commissioner

Dawn D. Stump, Commissioner

Alicia Lewis, Designated Federal Officer (DFO), Special Counsel, Division of Clearing and Risk, CFTC

AGENDA

P R O C E E D I N G S

MS. LEWIS: Good morning. Good afternoon, I should say. As the MRAC Designated Federal Officer, it is my pleasure to call this meeting to order. This is Alicia Lewis.

Before we begin this afternoon's discussion, I would like to turn to Commissioner Rostin Behnam, MRAC sponsor; and Nadia Zakir, MRAC chair, for opening remarks. Commissioner Behnam?

COMMISSIONER BEHNAM: Thank you, Alicia.

Good afternoon, everyone. I want to thank everyone for taking the time to meet. We are having a telephone conference this afternoon because we have a few limited items to discuss and thought it would be worthwhile to have, instead of an in-person meeting.

Quick thanks to Tom Wipf as chair of the subcommittee, Ann Battle, and Agha Mirza as well, and Dennis McLaughlin for their participation today and a special thanks, of course, to Alicia Lewis and Nadia Zakir for their longstanding leadership and organization for this meeting.

We are starting to sort of produce some

results, and rubber is hitting the road here as we lurch towards 2021. And I love the subcommittees in the work streams are working towards a lot of deliverables and results. So continue to look forward to seeing the work product from the subcommittee. It is playing a huge role in the larger transition away from LIBOR. And as I go around the country and travel as well at conferences, I think the MRAC's work is being recognized in a very positive lighting and doing a really important job in contributing to the larger task at hand that the ARRC and other organizations are leading.

So thanks again to everyone, look forward to this afternoon's discussion and future discussions, as well. Thanks.

MS. LEWIS: Thank you, Commissioner Behnam.

Chair Zakir?

CHAIRPERSON ZAKIR: Thank you, Alicia.

As Commissioner Behnam noted, today's meeting is being convened at the request of the Interest Rate Benchmark Reform Subcommittee to discuss a number of developments involving LIBOR transition. In particular, the Interest Rate Benchmark Reform Subcommittee was formed in September 2018 with the objective of providing reports and recommendations to the MRAC and ultimately the Commission regarding ongoing efforts to transition U.S. dollar derivatives and related contracts to the Secured Overnight Financing Rate, or SOFR, and the impact of this transition on the derivatives market.

We are pleased to welcome the members of the subcommittee today to present their initial recommendation regarding the adoption of plain English disclosures for new derivative contracts referencing LIBOR and other IBORs and to discuss other key developments in the LIBOR transition, including proposals from essential counterparties regarding their respective price alignment transition plans and clearing treatment for physically settled swaptions. Thank you to the members of the subcommittee for your work on this important issue. Thank you to Commissioner Behnam and to the Chairman’s Office, Commissioners Stump, Quintenz, and Berkovitz for their participation on today’s call. Also thank you to

Alicia Lewis and the CFTC staff for their hard work in organizing this teleconference meeting.

Turning to the agenda, before we begin, we would like to do a roll call of the members, speakers, and CFTC commissioners on the phone so we have your attendance on the record. After Alicia says your name, please indicate that you are present.

MS. LEWIS: Salman Banaei?

MR. BANAEI: Present.

MS. LEWIS: Stephen Berger?

(No response.)

MS. LEWIS: Lee Betsill, CME?

MR. BETSILL: Present.

MS. LEWIS: Isaac Chang, AQR Capital Management?

(No response.)

MS. LEWIS: Bis Chatterjee, Citigroup?

MR. CHATTERJEE: Present.

MS. LEWIS: Alicia Crighton, FIA?

MS. CRIGHTON: Present.

MS. LEWIS: Matthias Graulich, Eurex? Matthias Graulich, Eurex?

(No response.)

MS. LEWIS: Frank Hayden, Calpine Corporation?

MR. HAYDEN: Present. I am here.

MS. LEWIS: Lindsay Hopkins, Minneapolis Grain Exchange?

MS. HOPKINS: Present.

MS. LEWIS: Annette Hunter, Federal Home Loan Bank of Atlanta? Annette Hunter?

(No response.)

MS. LEWIS: Vincent B. Johnson, BP?

MR. JOHNSON: Present.

MS. LEWIS: Demetri Karousos, Nodal Exchange?

MR. KAROUSOS: Present.

MS. LEWIS: Derek Kleinbauer, Bloomberg SEF?

MR. KLEINBAUER: Present.

MS. LEWIS: Laura Klimpel, DTTC? Laura Klimpel, DTTC?

(No response.)

MS. LEWIS: Sebastiaan Koeling, FIA Principal Traders Group?

MR. KOELING: Present.

MS. LEWIS: Kevin McClear, ICE? Kevin McClear, ICE?

(No response.)

MS. LEWIS: Dennis McLaughlin, LCH Group?

MR. MCLAUGHLIN: Present.

MS. LEWIS: Craig Messinger, Virtu Financial?

MR. MESSINGER: Present.

MS. LEWIS: Dale Michaels, The Options Clearing Corp?

MR. MICHAELS: Present.

MS. LEWIS: John Murphy, Commodity Markets Council?

MR. MURPHY: Present.

MS. LEWIS: Christina Norland, Chatham Financial?

MS. NORLAND: Present.

MS. LEWIS: Sam Priyadarshi, Vanguard?

MR. PRIYADARSHI: Present.

MS. LEWIS: Jonathan Raiff, Nomura?

MR. RAIFF: Present.

MS. LEWIS: Marnie Rosenberg, JP Morgan?

MS. ROSENBERG: Present.

MS. LEWIS: James Shanahan, CoBank?

MR. SHANAHAN: Present.

MS. LEWIS: Lisa Shemie, Cboe?

MS. SHEMIE: Present.

MS. LEWIS: Betty Simkins?

MS. SIMKINS: Present.

MS. LEWIS: Tyson Slocum?

MR. SLOCUM: Yes, I am here.

MS. LEWIS: Marcus Stanley?

MR. WIPF: Tom Wipf?

MS. LEWIS: Tom Wipf is not on the committee. However, we will circle back to you, Tom, in a second.

MR. WIPF: I thought you said Morgan Stanley. I'm sorry.

MS. LEWIS: Yes. Marcus Stanley, Americans for Financial Reform?

(No response.)

MS. LEWIS: Robert Steigerwald, Federal Reserve Bank of Chicago?

MR. STEIGERWALD: Yes, present. Present.

MS. LEWIS: Janine Tramontana, Federal Reserve Bank of New York?

MS. TRAMONTANA: Present.

MS. LEWIS: Kristen Walters, BlackRock?

MS. WALTERS: Present.

MS. LEWIS: Suzy White, HSBC?

MS. WHITE: Present.

MS. LEWIS: Rana Yared, Goldman Sachs?

MS. YARED: Present.

MS. LEWIS: Scott Zucker, Tradeweb? Scott Zucker, Tradeweb?

(No response.)

MS. LEWIS: Okay. Chair Nadia, that completes your roll call.

Oh, I’m sorry. For the Interest Rate Benchmark Reform Subcommittee members, after I say your name, please indicate that you are present. Tom Wipf?

MR. WIPF: Here.

MS. LEWIS: Ann Battle?

MS. BATTLE: Present.

MS. LEWIS: Agha Mirza?

MR. MIRZA: Present.

MS. LEWIS: And I believe that we have three commissioners on the line or in the room. Could you please say, “Present” after I call your name? Commissioner Quintenz? Commissioner Quintenz?

(No response.)

MS. LEWIS: Commissioner Stump?

COMMISSIONER STUMP: Present.

MS. LEWIS: Commissioner Berkovitz?

COMMISSIONER BERKOVITZ: Present.

MS. LEWIS: Okay. Was there --

MR. GRAULICH: Matthias Graulich is also present. Sorry. You couldn’t hear me before. I don’t know why.

MS. LEWIS: Okay. Thank you, Matthias.

Chair Nadia?

CHAIRPERSON ZAKIR: Thanks, Alicia.

So just a few logistical reminders before we get started. Committee members and speakers, if you can please keep your phones on mute during the presentation and refer to the meeting instructions if you wish to make a comment or ask a question? I will recognize the members who wish to speak. If there are follow-up comments or questions after your initial statement, just please be sure to state your name and your firm.

The first item on the agenda is a report from the MRAC's Interest Rate Benchmark Reform Subcommittee on its work to date. Again, many thanks to the subcommittee and its chair, Tom Wipf, vice chairman, institutional securities at Morgan Stanley and chair of the Alternative Reference Rates Committee, for the great work done so far.

Tom, please provide your report.

MR. WIPF: Thank you, Nadia. And good afternoon, everyone. Thank you for making the time for this conference call outside of the normal biannual MRAC meeting schedule. Given the direction of travel and the pace of recent developments, we felt that it was important to get today's agenda items in front of the MRAC in advance of the November meeting.

Before we begin, I would like to note that I will not be commenting on behalf of Morgan Stanley, the ARRC, or any other organizations today. And the views that I represent are strictly my own and those of the subcommittee that I chair, as previously established by the MRAC.

I want to take a moment to thank Commissioner Behnam, Alicia Lewis, Nadia Zakir, the MRAC, and the rest of the CFTC for the formation of this subcommittee. The transition to alternative reference rates is a massive task ahead of us. And to achieve success, it is paramount that we have close coordination between the public and private sectors. I would also like to thank the members of the subcommittee for their hard work over the past year. The full subcommittee has now had three conference calls, with several more calls and correspondences occurring between the working groups and the dedicated working group leaders.

I would like to begin by first recapping the key developments in the LIBOR transition that have occurred since we last spoke in June and then discuss our three agenda items. The three agenda items are as follows: one, vote on the recommendations of the subcommittee related to plain English disclosure language; two, discuss proposals from central counterparties regarding adjustments to discounting and price alignment interest; three, discuss the clearing treatment for certain physically settled swaptions.

Developments in the LIBOR transition. Since June, there have been a number of important developments in the LIBOR transition, driven by both regulators and market participants. Regulatory developments include the following. FASB voted to provide accounting relief for contract modifications and hedging relationships impacted by the LIBOR transition. The proposal for this relief was issued last week.

The SEC released guidance on appropriate disclosures for dealers and investment managers that are trading, investing in, or selling LIBOR-linked products. The FHFA suggested that they will eventually prohibit Fannie and Freddie from purchasing LIBOR-linked mortgages at some point.

The Treasury Borrowing Committee noted in their meeting minutes that they are supportive of the U.S. Treasury issuing a floating rate note tied to SOFR pending further analysis on how this may impact demand for existing U.S. Treasury floating rate notes.

IOSCO issued a statement noting that the best risk mitigation to a LIBOR cessation event is moving to RFRs now. This is consistent with the message that the ARRC has been delivering for months that the best way out of a hole is to stop digging. The Financial Stability Oversight Committee discussed the LIBOR transition in their September meeting last week.

Just last month, we received the first indication that the U.S. Treasury may have guidance on tax consequences of converting legacy LIBOR positions. We are still waiting to see the final guidance, but this is certainly encouraging.

Market developments include the following. The ARRC provided additional details on how to construct a SOFR-based ARM product. This is usually a significant development for the consumer market and shows how SOFR in its current form can be used for many products.

The clearinghouses have come out with initial proposals for how they will adjust discounting and price alignment interests. This will be the focus of much of our conversation today.

In discussing our proposals, first, plain

English disclosures, the first order of business for today's meeting is to discuss and vote on the plain English disclosure language drafted by the subcommittee. I will let Ann discuss this language in greater detail, but at this point, you should all be familiar with it. Note that this language was drafted by the Disclosures Working Group and reviewed by the broader subcommittee.

The key motivation behind this language was to have a standard set of disclosures that market participants can incorporate in their documents that will adequately inform their clients and counterparties about the implications of using LIBOR-based products. They may not be perfect for every market participant. So firms should be encouraged to amend as needed for their respective organizations. For instance, they are written on a transactional basis but could be provided on a relationship basis instead.

Substantively, similar disclosures developed by a particular bank are also fine. However, all traders that continue to engage in LIBOR and other IBOR transactions should be aware of the disclosures or other internal disclosures and should endeavor to ensure that they are distributed to counterparties in an operationally feasible and efficient way.

After discussing these disclosures, we would like to initiate a vote by the MRAC to approve this language. If approved by the MRAC, these would be submitted to the Commission for consideration and would be hosted on the MRAC section of the CFTC’s website.

The second item for today is CCP adjustments to discounting and price alignment interests. Another key focus from the subcommittee has been discussing areas of coordination and potential risk considerations from the current proposals put forth for discounting and price alignment interest adjustments from both LCH and CME. We will hear shortly from Dennis McLaughlin of LCH and Agha Mirza of CME, who will both give brief overviews of their existing proposals. There are certain differences between their respective proposals that the subcommittee recognized as potentially challenging from an economic and an operational perspective.

There was desire from the subcommittee for consistency across the clearinghouses in how they approach this adjustment to the greatest extent possible. A few areas of concern were the timing of the adjustments, the pricing mechanism for cash compensation, and the methodology by which ongoing-basis risk was compensated. We would like to discuss these issues today but recognize that the discussion is likely too extensive for a single session and that ultimately both clearinghouses will enact plans that best represent their clients' preferences.

However, the subcommittee would like to gauge from the MRAC on how to best approach coordination between the clearinghouses where possible. Guidance regarding the appropriate form for these discussions, whether it is within the subcommittee, within the MRAC, or within the CFTC, would be helpful. The subcommittee feels that a larger degree of communication and coordination between the clearinghouses will have a highly beneficial effect on the single-step transition for the market.

The third item is clearing treatment for certain physically settled swaptions. Finally, the clearing treatment for certain physically settled swaptions has been a point of discussion in the subcommittee as well as in the broader market. Notably, in the current construct of the single-step transitions at both clearinghouses, there may be valuation discrepancies that arise in these products. I will discuss the mechanics of this issue in greater detail later this afternoon. The subcommittee felt that it is likely too premature to propose any sort of relief to the MRAC, but, rather, we would appreciate your guidance on how we should approach this issue.

It has been suggested by certain market participants that exempting these specific swaptions from clearing mandate could be a solution, though the implications of this have not been fully vetted. CME’s presentation shortly will suggest a potential solution to this issue that they will look to gather market feedback on as well. We look forward to introducing this discussion to the public domain and getting your feedback.

Next steps. The subcommittee’s work will continue after this meeting. And we intend to have another update for this group at the November MRAC meeting. To the extent the MRAC approves the disclosure language today, we would expect to make that accessible to market participants in short order. The plain English disclosures will be posted on the MRAC section of the CFTC site, and supplementary information will be posted on ISDA's site.

I expect the discussion of coordination between the clearinghouses on their respective single-step proposals will be ongoing for the next several weeks and months. Pending your input today, we will determine if the subcommittee is the preferred venue for such coordination or if perhaps November's MRAC or another CFTC forum may be more appropriate. Timely resolution of these discrepancies is important for market participants as the operational work needed to prepare for this significant change may be time-consuming for many firms.

For the swaptions discussion, we will take the MRAC's guidance into how this should be approached within the subcommittee. The ARRC is also taking a look at this issue, but ideally we would combine forces with the MRAC to ensure a timely resolution. Depending on the solution reached by the market, there may be significant repapering or operational work ahead for many firms.

We welcome any and all feedback from MRAC on our areas of focus that we have discussed today. The MRAC and the CFTC’s guidance has been helpful to our work thus far, and we look forward to further collaboration with this group. Once again, I would like to thank Commissioner Behnam, Alicia Lewis, Nadia Zakir, and the MRAC for the opportunity to provide this public service.

CHAIRPERSON ZAKIR: Thank you, Tom.

At this time, I would like to open the floor to questions and comments from the membership on the report.

MS. LEWIS: Committee members, you have received meeting instructions, which indicate how you can ask a question and be placed in the queue. Please refer to that information.

(Pause.)

MS. LEWIS: Chair Nadia, there appears to be no questions.

CHAIRPERSON ZAKIR: Okay. Since there are no questions or comments on the report, I would like to ask Ann Battle to present the recommendation from the subcommittee regarding the plain English disclosures that have been circulated to the MRAC in advance of this meeting. Ann is the subcommittee’s Disclosure Working Group leader and an assistant general counsel at ISDA. For members of the public who are listening on the phone, the voting draft of the disclosures are on the CFTC’s MRAC meetings webpage.

Ann, you may please begin.

MS. BATTLE: Thank you, Nadia. And thank you, Tom. Thank you as well to the CFTC, Commissioner Behnam, Alicia, and the MRAC, for the opportunity to present.

As Tom described earlier this year, the Interest Rate Benchmark Reform Subcommittee formed a Disclosures Working Group to produce plain English disclosures for use by firms that continue to transact in LIBOR. The Interest Rate Benchmark Reform Subcommittee recommends that market participants use some type of plain English disclosures when facing all counterparties with whom they continue to transact derivatives referencing LIBOR and similar IBORs. The proposed disclosures are intended as helpful examples of plain English disclosures that market participants could use as they determine appropriate. For example, the disclosures may be appropriate if market participants do not have their own disclosures or if they prefer to use something that is publicly available and standardized.

The proposed disclosures are written on a transaction-by-transaction basis but could be provided on a relationship basis if that is more operationally feasible. Substantively similar disclosures developed by a particular bank or firm would also satisfy the objectives of the Interest Rate Benchmark Reform Subcommittee. The subcommittee believes that all traders and others who continue to transact referencing LIBOR and other IBORs should be aware of these disclosures or other internal disclosures and should endeavor to ensure that they are distributed to all counterparties in an operationally feasible and efficient way.

The proposed disclosures are written so that they are helpful to all market participants, including those who have no knowledge of benchmark reform, existing fallback provisions, and derivatives and other instruments or efforts to implement new fallback language.

The proposed disclosures contain four options based on, one, whether a transaction references LIBOR, which is expected to cease in the near term, or it references another IBOR that may or may not cease in the near term; and, two, whether the transaction is entered before or after ISDA updates its standard definitions for derivatives, to include new fallbacks. For transactions entered before ISDA updates its standard definition, the disclosures note that, despite contractual provisions for attempting to determine a fallback rate, it is unclear what rate the contract would reference if the relevant IBOR is discontinued. These disclosures also encourage counterparties to consider amending their IBOR-referencing contracts, to include the new fallbacks once those fallbacks are final in early 2020.

For transactions entered after ISDA updates its standard definitions, the disclosures note that the fallback rates that would apply upon the discontinuation of an IBOR are inherently different from the IBOR. The proposed disclosures generally warn counterparties of potential economic implications, of continuing to transact in LIBOR and other IBORs, and mismatches that could occur across derivatives and other financial instruments.

The disclosures reflect feedback from members of the Interest Rate Benchmark Reform Subcommittee and the MRAC. In response to this feedback, we specifically revised the disclosures to, one, note that counterparties should consider using an ISDA protocol to add the new fallbacks once those fallbacks are final but clarify that they would not be required to do so; two, clarify that counterparties could also seek to enter bilateral amendments to add the new fallbacks as an alternative to using a multilateral ISDA protocol. Note that counterparties should consider tax accounting and regulatory implications of continuing to enter transactions referencing LIBOR and other IBORs or recognize that existing derivative transactions do include a process for attempting to determine a fallback rate if LIBOR or another IBOR is discontinued, although it is unclear what the result of that process would be. And, five, note that spread adjustments are contemplated in connection with the new fallback to address the inherent differences between the IBORs and the fallback rate, although the spread adjustments will not perfectly replicate the IBORs on an ongoing basis.

Nothing in the proposed disclosures would amend or supersede the terms of any transaction or any related governing documentation. Information in the disclosures would remain subject to the terms of the relevant transactions and documentation governing those transactions.

The disclosures are separate and distinct from the more comprehensive disclosures that ISDA has published for use in compliance with CFTC rule 23.431, "Disclosures of Material Information." The Disclosures Working Group of the Interest Rate Benchmark Reform Subcommittee has recommended that ISDA consider updating these more comprehensive disclosures at a later date once ISDA has updated its standard definitions to include the new fallbacks.

With that background, the Interest Rate Benchmark Reform Subcommittee recommends, one, that the MRAC approve the disclosures which may be used by market participants as they deem appropriate; and, two, that the MRAC recommend to the Commission that the Commission consider the disclosures.

CHAIRPERSON ZAKIR: Thank you, Ann.

Committee members, you have heard the recommendation coming from the subcommittee. Is there a second?

(Pause.)

MR. WIPF: If there are any MRAC members who are on our subcommittee, having recommended that, it would be appreciated if they could second the motion.

(Pause.)

MR. WIPF: Alicia, to get the second, someone needs to hit *1. Is that correct?

MS. LEWIS: Yes. And I think we have Marnie Rosenberg.

CHAIRPERSON ZAKIR: Marnie. Yes, Marnie Rosenberg?

MS. ROSENBERG: Yes. I second the motion. I am having problems. Do you guys hear me?

MS. LEWIS: Yes. Thank you.

MS. ROSENBERG: Oh, okay. Okay. Yes. I second the motion.

CHAIRPERSON ZAKIR: Thank you, Marnie.

It has been moved and properly seconded that the MRAC approve the plain English disclosures, which may be used by market participants as they deem appropriate, and that the disclosures be submitted to the Commission for consideration. Is there any discussion? The floor is open for questions and comments from the membership at this time. Jim Shanahan, CoBank?

MR. SHANAHAN: For approval.

MS. LEWIS: Jim, you have the floor.

CHAIRPERSON ZAKIR: Frank Hayden, Calpine?

MR. HAYDEN: About to vote on systemic banks or types of counterparties involved in the plain English disclosures or is it pretty much universal across all groups of folks doing business under that?

CHAIRPERSON ZAKIR: I'm sorry. It was difficult to hear the beginning of your question.

MR. HAYDEN: Yes. So the question is, is that these recommendations for the IBOR/LIBOR fallback provision language, are they specific to a particular type of counterparty, such as a globally, systemically important bank or an end-user or a swap dealer or are they pretty much across the board?

MS. BATTLE: They are across the board for market participants, those who are very sophisticated and involved in this transition and those who are not. Given that a discontinuation of LIBOR, in particular, would affect all market participants equally, the disclosures should be appropriate for all market participants who continue to transact in LIBOR.

MR. HAYDEN: Okay. Thank you.

CHAIRPERSON ZAKIR: Sam Priyadarshi, Vanguard?

MR. PRIYADARSHI: Yes. Hi. Thanks, Nadia, Alicia, Tom, and Ann. I have a question. Can this draft be shared with our respective firms prior to it being published on the MRAC website?

MR. WIPF: I don’t think we are -- I think that we are hoping to get comments here today. I don’t think we are -- this is not for a comment period I think with the amount of work that went behind it. I think the goal would be if there are particular concerns or considerations, but, again, since this is not mandatory by any stretch or it is really -- I mean, the goal here has been from the beginning, as Ann described, the idea, you know, to give people something that they could use, you know, to hopefully to some degree for those who like to use it limit the proliferation of these types of disclosures and get something into the market that, you know, we can move out in a reasonably efficient amount of time that would be helpful for people who are not as up to speed as the people on this call.

Nadia, is that correct in terms of just process and protocol?

CHAIRPERSON ZAKIR: Yes, I believe that is accurate. Yes.

MR. WIPF: Thank you.

CHAIRPERSON ZAKIR: I think the purpose here is to go ahead and take a vote on this final draft today. So if there is no further discussion, we will take a vote on the recommendation from the Interest Rate Benchmark Reform Subcommittee that the MRAC approve the plain English disclosures, which may be used, as we mentioned earlier, by market participants as they deem appropriate and that the disclosures be submitted to the Commission for consideration. As a point of order, a simple majority vote is needed for the motion to pass.

MS. LEWIS: Before we start with the round of voting, I just want to give an opportunity for those members who may have joined the call late to be on the record. Stephen Berger, Citadel?

MR. BERGER: I am here. Can you hear me?

MS. LEWIS: Yes. Isaac Chang, AQR Capital Management?

(No response.)

MS. LEWIS: Annette Hunter, Federal Home Loan Bank of Atlanta? Annette Hunter?

(No response.)

MS. LEWIS: Laura Klimpel, DTTC?

(No response.)

MS. LEWIS: Marcus Stanley, Americans for Financial Reform?

(No response.)

MS. LEWIS: Scott Zucker, Tradeweb? Scott Zucker, Tradeweb?

(No response.)

MS. LEWIS: Well, Scott has sent an email that he is on the call.

MR. ZUCKER: Yes. I am present.

MS. LEWIS: Okay. Thank you.

MR. ZUCKER: Sorry.

MS. LEWIS: All right. So we have 32 members present. So I am going to go through. And please indicate your agreement with "Aye" or disagreement with "Nay" or abstain if you are abstaining from the vote. Okay.

Salman Banaei?

MR. BANAEI: Aye.

MS. LEWIS: Salman Banaei votes aye.

Stephen Berger?

MR. BERGER: Aye.
MS. LEWIS: Stephen Berger votes aye.
Lee Betsill?
MR. BETSILL: Aye.
MS. LEWIS: Lee Betsill votes aye.
Bis Chatterjee?
MR. CHATTERJEE: Aye.
MS. LEWIS: Bis Chatterjee votes aye.
Alicia Crighton?
MS. CRIGHTON: Aye.
MS. LEWIS: Alicia Crighton votes aye.
Matthias Graulich?
MR. GRAULICH: Aye.
MS. LEWIS: Matthias Graulich votes aye.
Frank Hayden?
MR. HAYDEN: Aye.
MS. LEWIS: Frank Hayden votes aye.
Lindsay Hopkins?
MS. HOPKINS: Aye.
MS. LEWIS: Lindsay Hopkins votes aye.
Vincent Johnson?
MR. JOHNSON: Aye.

MS. LEWIS: Vincent Johnson votes aye.
Demetri Karousos? Demetri Karousos?
(No response.)
MS. LEWIS: Derek Kleinbauer?
MR. KLEINBAUER: Aye.
MS. LEWIS: Derek Kleinbauer votes aye.
Laura -- I'm sorry. Sebastiaan Koeling?
MR. KOELING: Aye.
MS. LEWIS: Sebastiaan Koeling votes aye.
Kevin McClear?
MR. McCLEAR: Aye.
MS. LEWIS: Kevin McClear votes aye.
Dennis McLaughlin?
MR. MCLAUGHLIN: Aye.
MS. LEWIS: Dennis McLaughlin votes aye.
Craig Messinger?
MR. MESSINGER: Aye.
MS. LEWIS: Craig Messinger votes aye.
Dale Michaels?
MR. MICHAELS: Aye.
MS. LEWIS: Dale Michaels votes aye.
John Murphy?

MR. MURPHY: Aye.
MS. LEWIS: John Murphy votes aye.
Christina Norland?
MS. NORLAND: Aye.
MS. LEWIS: Christina Norland votes aye.
Sam Priyadarshi?
MR. PRIYADARSHI: Aye.
MS. LEWIS: Sam Priyadarshi votes aye.
Jonathan Raiff?
MR. RAIFF: Aye.
MS. LEWIS: Jonathan Raiff votes aye.
Marnie Rosenberg?
MS. ROSENBERG: Aye.
MS. LEWIS: Marnie Rosenberg votes aye.
Jim Shanahan?
MR. SHANAHAN: Aye.
MS. LEWIS: Jim Shanahan votes aye.
Lisa Shemie?
MS. SHEMIE: Aye.
MS. LEWIS: Lisa Shemie votes aye.
Betty Simkins?
MS. SIMKINS: Aye.

MS. LEWIS: Betty Simkins votes aye.

Tyson Slocum?

MR. SLOCUM: Aye.

MS. LEWIS: Tyson Slocum votes aye.

Kristen Walters?

MS. WALTERS: Aye.

MS. LEWIS: Kristen Walters votes aye.

Suzy White?

MS. WHITE: Aye.

MS. LEWIS: Suzy White votes aye.

Rana Yared?

MS. YARED: Aye.

MS. LEWIS: Rana Yared votes aye.

Scott Zucker?

MR. ZUCKER: Aye.

MS. LEWIS: Scott Zucker votes aye.

Nadia, it is basically unanimous.

CHAIRPERSON ZAKIR: Basically, the ayes have it, and the motion has passed. The plain English disclosures have been approved by the MRAC and will be submitted to the Commission for consideration.

The next item on the agenda is the CCP

proposals for transitioning discounting and price alignment interest to the Secured Overnight Financing Rate. I will turn it over to Tom to introduce the topic and the speakers.

MR. WIPF: Thank you, Nadia. And thank you to Ann, the working group, the MRAC, and all involved in this work.

I think we have -- I think these plain English disclosures will go a long way in this transition and ensuring that people in the market understand the consequence of this work. Thank you very much, all involved. And thank you to the MRAC for your support.

We are now going to move to the views of the subcommittee on a single step. We will introduce first Dennis McLaughlin, chief risk officer of LCH. And he will be followed by Agha Mirza, managing director and global head of interest rate products of the CME, who will discuss their draft proposals for a single-step change in discounting.

Dennis, we will pass to you to start it off. Dennis McLaughlin?

(No response.)

MR. WIPF: While we are waiting for Dennis, I would also note that the proposals from both CCPs are on the MRAC website for those playing along at home.

(Pause.)

MS. LEWIS: Dennis, the floor is open.

MR. McLAUGHLIN: Hello?

MS. LEWIS: Yes? We can hear you, Dennis.

MR. McLAUGHLIN: Okay. Thank you.

At the end of July this year, LTH sent out a document which after a membership consultation at the end of last year laid out the approach that the clearinghouse is going to take to the transition to U.S. dollars that have been discounted, but that was an extensive consultation. And one of the key takeaways from that consultation was that the majority of the members preferred quarter 3 period to make the transition. Specifically, we came back with a target date of October 17, 2020 as being the date which satisfied most of the numbers we had partaken in the consultation. The scope is for all U.S. dollar discounted positions in the talk here, including nondeliverable currencies, but this would include from emerging markets currencies because it is quite -- and these are nondeliverables because it is quite a logistical undertaking to try and manage your discounting at the same time. So it will be a big bang move. That is the plan.

The conversion process is planned to be a combination for clients where they can elect only cash-only compensation if they choose the carry broker. And the cash option is available only to clients. And then for members that are specifically banks, there is a risk compensation of the formal compensating swaps to be made. And each compensating swap will be a standardized Fed fund versus SOFR basis swap on one of the major benchmark tools.

Now, the exact mechanism for how this will work is still under discussion. And I would encourage anybody who has some opinions about what is going on or ideas about what to do in more detail to sending comments to the address SOFR@lth.com, and we would specifically welcome especially member consultation/comments but also anybody who has any ideas they might lend a point of view that is useful.

The coordination of bilateral trade, certainly any U.S. dollar cured by LTH after the conversion date will from the point of view of curing the discount with SOFR, irrespective of whether it originates from such a contract. The compensation process will only apply to swaps that are registered to LTH before the conversion date. And LTH is supported with any industry standard for bilateral compensation to be established for a counterpart to pay or receive compensating not for swaption contract. Any such process will ultimately need to be agreed between the bilateral counterparties to be able to trade. That is the main idea.

There will be an auction. The timing is for an auction just a day or two before October 17th if you set a date to cash-only election. And, as I said, some of the consultation is going to be solved on the precise mechanism.

That is just an overview of what we are trying to do. There is a paper that has been hopefully included in the pack, which lays out the -- which is, actually, the member communications from July 25th, 2019, which laid out the approach and asked for the consultation.

Thank you.

MR. WIPF: Thank you very much, Dennis. And we are going to ask if people could reserve their questions until we have heard from both clearinghouses. So, again, thank you very much, Dennis, for that presentation.

And we will now pass the floor to Agha from CME.

MR. MIRZA: Thank you, Tom, Alicia, Chair Nadia, and Commissioner Behnam, and the MRAC, for the opportunity today to provide an overview of CME's proposed approach. This is to achieve the single-day discounting conversion from effective hedge funds to SOFR for legacy-cleared swaps in furtherance of ARRC-based transition plan.

In this currently proposed approach, which I will outline shortly, it is very much the product of a thorough consensus exercise. Throughout 2019, we have conducted over 100 unique client meetings to discuss every element of our proposal. In addition, we have presented our proposed approach and frequently provided updates to the ARRC's market structure and based transition working group.

Our current proposal reflects the consensus opinions of our clients and how to best facilitate the discounting and price alignment transition while ensuring the principles of maintaining market stability and promoting effective risk management during the transition to risk-free rates.

Please note that our proposal is still marked as a draft, and it is available online and, as such, is subject to change based on additional market participant feedback.

Our approach is as follows. The scope of our discounting change reflects a phased approach. Our proposed July 2020 transition would be limited to cleared U.S. dollar interest rate swap products excluding CME-cleared SOFR swaps that are already in SOFR price line in a discounting environment. We are currently reaching out to our clients in regards to other products and currencies discounted in Fed funds.

Timing for our discounting change is currently proposed to occur over the weekend of July 17th, 2020, which was chosen based on client feedback and the consideration for the uncleared margin through phase V implementation in September 2020 and the U.S. presidential election in early November of 2020. The process will occur entirely over a weekend period and would include what CME refers to as cash compensation and discounting risk exchange elements.

To eliminate the transfer of value associated with this change, CME would make a cash adjustment at the individual swap level that is equal and opposite to the change in each cleared swap's net present value specifically attributable to the discounting change. Regarding discounting risk exchange, to mitigate hedging costs associated with this transition as well as the sensitivity to closing curve marks on the proposed date of July 17, 2020, CME would book a series of fact funds, SOFR basis swaps to participant accounts. These swaps would restore participants back to their original risk profiles and be booked at the July 17th, 2020 closing curve levels and will result in an NPV, or net present value, of zero dollars for the basis swaps.

Discounting risk exchange is a topic that was currently discussed during our client outreach efforts. And CME received feedback from buy-side and some other participants, who typically do not hedge discounting risk and, therefore, may not wish to hold resulting fact funds, SOFR basis swaps. These clients expressed that they would be interested in an auction service that enables them to exit these positions in a transparent manner. CME intends to engage third party providers to facilitate such an auction for any participants interested in such a service.

Finally, to address the treatment of legacy swaption exercises going forward after our single-day discounting conversion, CME is proposing to offer a service which would facilitate a standardized compensation methodology, forced swaption exercises, which will be executed under the premise that the resulting swap would be centrally cleared in a fact funds discounting regime. Such swaps will be flagged via a new field provided by affirmation platforms.

This will allow counterparties to signal for CME to calculate the difference in value between SOFR and fact funds discounting and settle a corresponding cash compensation adjustment. CME believes this approach provides counterparties the flexibility to either negotiate bilateral compensation agreements or utilize CME’s proposed standardized compensation methodology. CME fully supports efforts to promote liquidity in the SOFR benchmark.

We are very pleased that CME SOFR futures open interest recently reached a milestone of $1 trillion of representative notional. We believe the single-day discounting conversion will further enhance liquidity throughout the entire SOFR curve, and we are appreciative of the opportunity to partner with the industry to solve this complex problem.

Thank you, Tom.

CHAIRPERSON ZAKIR: Thank you, Agha.

Tom, could you please provide the subcommittee’s view on the proposals?

MR. WIPF: Yes. Thank you very much, Nadia. On our most recent call, the subcommittee received updates on the current proposals, as we have today, from both LCH and CME. We then did at that point ask the clearinghouses to exit the call so we could discuss our collective views candidly without them being part of the conversation. The key differences noted from our group were obviously, number one, timing. The CME is proposing July 2020. And, as you heard, the LCH is proposing October 2020.

Second was the pricing mechanism. CME is proposing using its standard end-of-day pricing to run valuations under effective Fed funds and SOFR PAI in discounting while LCH is proposing an auction similar to the procedures. It would run to close out positions in a default.

Basis swap allocation being the third, CME allocates basis swaps to all parties and allows them to manage or dispose of this risk as they see fit; whereas, LCH allows client accounts to opt out of receiving basis swaps.

It was the view of the subcommittee that it would be highly beneficial to the market if the clearinghouses worked to be more aligned on these key issues, including both the timing and the overall compensation mechanics, where possible. It was brought up on our call that keeping significant differences between the respective single-step plans could pose certain risks to the market.

To get input from the MRAC, we would like to pose the following discussion questions and open this up to the group. First, do you think it would be beneficial to market participants if the clearinghouses executed their respective single-step transitions at or around the same date?

Two, operationally for your firm, what length of time between the two single-step transitions is sufficiently small to minimize or mitigate operational risk?

Three, do you think it would be beneficial to market participants if the two clearinghouses executed their respective single-step transitions with similar compensation mechanisms?

And, four, as it relates to risk compensation, basis swaps, what issues do you foresee for your firm with respect to either of the current proposals?

So we would I think open that up to the group. Now I will pass back to Nadia.

CHAIRPERSON ZAKIR: Thanks, Tom.

We will now open the floor to questions and comments from the membership. Members, please refer to your instructions on how to pose a question. And we will maybe just pause for 30 seconds or so to give folks time to line up in the queue.

(Pause.)

CHAIRPERSON ZAKIR: Okay. Bis Chatterjee, Citigroup?

MR. CHATTERJEE: Thank you, Nadia. And thank you to Alicia and Commissioner Behnam for giving us an opportunity.

Nadia, if I could, I will probably just, you know, try to summarize the three or four main points that Tom laid out. And, you know, recognizing that Citi, you know, has a large presence both on the market-making or the house side as well as on our client and our fund-clearing franchise, I think we have to be careful about, you know, making sure we represent both views.

I think from our market-making perspective on the issue of timing, you know, while we may not have a strong preference we think from the client side, you know, there may be more interest from clients to closely align both dates. So, you know, that should be probably, you know, a strong consideration as to the preference of our clients.

On the operational front and timing, we don’t think there is a sufficient or that is a great, large concern for us. On the front of the present value and the compensation mechanisms, we are broadly supportive of using hedges and a PV cash maven. We think it, you know, has impacts and it reduces the lines of how you can map curves, especially if you are using longer-dated contracts and longer-dated curves.

Overall, I think that the conceptual alignment between the clearinghouses is beneficial to the marketplace. There may be parties that have offsetting positions or at least across parts of the curve. So it probably definitely makes sense to have some kind of alignment in the approach. Net-net, I think our main focus is we are probably broadly supportive of using basis swaps.

CHAIRPERSON ZAKIR: Thank you, Bis.

Our next comment is from Marnie Rosenberg, JPMC.

MS. ROSENBERG: Thank you, Nadia. Thank you, Alicia Lewis. And thank you, Commissioner Behnam, for hosting this call today.

I guess, like what Bis spoke about and Citi, obviously JP Morgan is the major dealer and clearer in the market. And I will just present our views based on the questions that Tom posed.

So to the first question, do you think it would be beneficial to market participants if CME and LCH executed their respective transitions on or around the same date, yes, we do. We think it actually reduces operational risk to be done on the same day.

We prefer the October date that LCH has proposed, not only from an operational risk perspective, but it is just mentioned from a liquidity perspective. There could be offsetting trades which could be moved together. We also think that products with discounting off of Fed funds should be moved together where there is overlapping clear products particularly.

In terms of compensation mechanisms, we think to the extent that the compensation approaches, both from a risk compensation and cash compensation approach, it would be very helpful for the market to work towards, you know, a single methodology on both fronts.

And in terms of the specifics on risk compensation and issues, we think it is best to discuss in a broader group of market participants that are focused on this along with CME and LCH.

Thank you.

CHAIRPERSON ZAKIR: Thank you, Marnie.

Stephen Berger, Citadel?

MR. BERGER: Thank you.

So I will go through the questions in the same order as the previous commenters did. So yes, we do think it would be beneficial if the two CCPs executed their transitions at or around the same date. So we would like those two dates brought much closer together. Operationally, you know, we think within a week would be best. It doesn’t necessarily have to be on the same day, but definitely within a week of each other would be preferable. We do think it would be beneficial for the two CCPs to do the transitions with similar compensation mechanisms. So we have a strong view that it would be unnecessarily complicated otherwise.

And then with respect to risk compensation and the basis question, I think there are a number of challenges and risks we see there that need to be carefully thought through. Any auction process in this space is I think going to be challenging because you are going to have a lot of people -- you are going to have a lot of one-way kind of flow coming into the auction, which I think is going to make finding like the equilibrium price challenging and diversion from what expectations might be. And it is just not clear like that there is going to be a market right off the bat for the new basis swaps. So prices could move a lot, even right after the auction. And I think there are a variety of client segments that don’t have a lot of experience trading basis swaps. And so I appreciate that one of the approaches is to have a cash-only compensation mechanism, but that may not be universally used by everybody.

So -- and then I think, you know, going down the road, if you have like a 30-year basis swap and you want to be able to trade out of it, there is a question in terms of like what, how many counterparties are really going to be there to do those trades.

So I think on the risk compensation front, there is still a number of issues that we need to think carefully through.

CHAIRPERSON ZAKIR: Thank you, Stephen.

Rana Yared, Goldman Sachs?

MS. YARED: Hi. Good afternoon. And thank you for your time.

Taking the questions in order, as the previous group has done, we think that there is benefit in having the two conversion dates aligned. We have a preference for the July date because we think that the sooner that the date takes place, the greater support can be provided for SOFR in terms of liquidity in the marketplace. And we view that to be the ultimate end goal of everyone involved in moving towards the risk-free rate, which was the provision of liquidity for the ultimate rate.

On the question of mechanism, we would also have a preference for similar compensation mechanisms and agree with a comment that was made that an auction mechanism could potentially be challenging due to the one-way market with mostly nondirect members opting to not take the basis swaps option. And so in the event that there is an auction mechanism, there needs to be a contemplation, as Marnie said, in a larger group around what would happen if there is no one on the other side.

CHAIRPERSON ZAKIR: Thank you, Rana.

If there are no further comments or questions, this concludes our discussion regarding the CCP proposals for transitioning PAI and discounting to SOFR. Many thanks to our speakers.

MS. LEWIS: Nadia? One moment. I just wanted to give Dennis and Agha and Tom an opportunity to respond to what they have heard so far, if there is anything.

MR. WIPF: Yes. I will start here. This is Tom. I think what we are hearing is I think very consistent with what we have heard at the subgroup, that there is a desire for consistency where possible and obviously a desire for complete consistency if possible.

I think where we will be left the next steps is where, in fact, is an appropriate place for that conversation to occur. It is very clear I think that what we are hearing from the market participants on this call as well as the subgroup and those who have spoken up. We haven't heard much, if anything, to the contrary. So I think we have got plenty to work with. I think the clearinghouses have plenty to work with.

My open question I think we -- which I think will be the next step for all of us to consider is where, in fact, could those conversations occur in an appropriate venue with obviously a clear eye on antitrust concerns.

So I will pass it back, Alicia and Nadia, back to you. And let's see what we hear from Dennis and Agha.

CHAIRPERSON ZAKIR: Dennis and Agha, if either of you have any further comment, the floor is yours.

MR. MIRZA: Thank you, Nadia. This is Agha Mirza from CME Group.

You know, I just would like to reiterate that in the light of the comments that were made, that we are fully supportive of an approach that is aligned between the CCPs. You know, if you look at current proposal available online, it is clearly marked “Draft” and reflects the input and insight that we received to our 100-plus client meeting thus far.

Having said that, we continue to have additional client meetings and would be very much open to receiving feedback and accommodating market and client preferences.

Thank you.

MS. LEWIS: This is Alicia Lewis. I just want to remind everyone that you can still provide comments to the email addresses that are on the draft of the proposals. So comments can be still directed to those email addresses.

CHAIRPERSON ZAKIR: Okay. If there are no further comments, again, many thanks to our speakers. The last item on the agenda is a discussion regarding the clearing treatment for certain physically settled swaptions. I will turn it back over to Tom.

MR. WIPF: Thank you very much, Nadia.

As we know, we are going to try to discuss this issue. It is we believe something that has been developing but not necessarily -- we are looking for just some guidance from this group, understanding that this is fairly early in the process. As you know, most swaptions in the market trade bilaterally and are not cleared. And because of this, their present value is generally calculated as a series of outcomes and rates discounted to present day using a discount curve agreed upon by the counterparties. This can vary across market participants, but for the most part, U.S. dollar swaptions will be discounted with Fed funds. To the extent these options expire in the money, they will often be settled physically in the form of swaps, as opposed to cash settlement. These swaps are subject to CFTC's clearing mandate and assuming there is no preexisting reason for the swap to be exempt from these requirements. In the current discounting and price alignment interest environment perpetuated by the clearinghouses, these cleared swaps are discounted at Fed funds, too. So there is a match between discounting curves for the bilateral option and the cleared swap upon settlement.

However, a potential issue arises if a single-step transition occurs in the clearinghouses and they begin discounting these settled swaps with SOFR because the original swaption was priced with the assumption that Fed funds would be used as a swaps discounting curve.

Importantly in this scenario, the swap would appear. So the clearinghouse would be a new trade, instead of a physical settlement from a legacy swaption. Thus, it would not be eligible for cash or risk compensation. This is different form legacy swaps that would be eligible for both cash and risk compensation under the current single-step proposals.

Another example that has been discussed in the market is if you have a swaption that is very deeply in the money such that it trades quite similarly to a swap, a market participant wished to hedge that delta risk on this swaption by using a cleared swap. When the single-step date occurs, the cleared swap hedge will be eligible for cash and risk compensation, but the option will not be eligible for such compensation upon expiry. And these two products, which mirror each other closely, would now have a valuation discrepancy that did not exist prior to the single step.

Neither the subcommittee nor the ARRC have reached a conclusion about the best risk management strategy for this issue, though the topic has been discussed to some degree of both forms. One idea that has been suggested elsewhere in the market is that if the CFTC provided relief from the clearing mandate for physically settled swaptions, swaps could be booked bilaterally upon expiry and must be discounted with the same dealer curve as the original swaption. Our subcommittee has not vetted the benefits and considerations of this approach, so at the moment cannot endorse such a recommendation.

Another possible solution is from I think the recent CME proposal, where they suggest clearing members can identify swaps as the result of swaption expirations and the clearinghouse can distribute cash compensation accordingly. The subcommittee, again, feels that it is too premature to endorse any solution at this point, but we welcome your guidance on whether or not this is an issue that should be a key part of our work over the coming months.

Again, input from the MRAC, we would like to post the following discussion questions. One, do you view the potential valuation differences that may result in physically settled swaptions vis-a-vis discounting risk to be an issue for your respective firm or your clients?

Two, do you think the subcommittee is an appropriate venue to discuss this issue? And if so, do you think that a request for targeted clearing relief from the CFTC should factor, even factor, into the subcommittee's discussions?

And we will, then, open up that for any comments on this topic, although we do -- you know, as we said earlier, this is a developing topic.

CHAIRPERSON ZAKIR: Thanks, Tom.

So at this time, I would like to go ahead and open the floor to questions and comments from the membership. Why don’t we start with Frank Hayden, Calpine?

MR. HAYDEN: Can you hear me?

CHAIRPERSON ZAKIR: We can hear you.

MS. LEWIS: Yes.

MR. HAYDEN: Okay. Yes. So my question was really, you know, maybe -- you know, just taking a step back, thinking about the margining process and, you know, how risk is calculated on positions at the exchanges and how, you know, that span calculation kind of encourages companies to, you know, either pony up more money to support the trade to render, actually to exit the position. And I am kind of curious. Given that we know that LIBOR is dying, I am kind of curious if there is some thought being put into the basic risk calculation on clearing these sorts of products that have this legacy IBOR-type index and if, in fact, you know, that could, in fact, be kind of like a stick to encourage people to start putting on, you know, basis trades between SOFR and LIBOR to kind of create, you know, so some liquidity would develop because, obviously, given the comments in the earlier section with regards to, you know, the auction being one way and obviously given the comments around the dates and people kind of concerned about summer liquidity, fall liquidity, people being around, it seems like there should be some signals put into the marketplace to start encouraging people to start thinking about these sorts of risks other than just, you know, sending out, you know, advisories and notes and fallback provisions they may or may not even look at. I am just curious from an exchange perspective if something is being done with regards to the margin calculation for these dying instruments, if you will.

Thank you.

CHAIRPERSON ZAKIR: Thanks, Frank.

Before I move to the next question here, Tom, did you have any reactions to that?

MR. WIPF: I think it is a very appropriate question. I think maybe we should see if the clearinghouses have some views on that particular aspect of this work.

(Pause.)

CHAIRPERSON ZAKIR: Okay. So let's move. Let's move to the next question here.

MR. WIPF: I'm sorry, Nadia. As a subcommittee, we can take that question under advisement --

CHAIRPERSON ZAKIR: Yes.

MR. WIPF: -- and be able to respond back to this committee.

CHAIRPERSON ZAKIR: Yes.

MR. WIPF: Thank you.

CHAIRPERSON ZAKIR: Okay. Great. Thank you, Tom.

Let's move to Bis. Bis Chatterjee at Citigroup?

MR. CHATTERJEE: Thank you, Nadia.

You know, I think Tom's comments at, you know, the start of the discussion are interesting. I think from our perspective, we view this as kind of a developing area. The subcommittee certainly feels like the right place where we should have, you know, some of these discussions. You know, in our overall perspective, I think, you know, there is both legal and risk considerations we need to look at. And so to the extent that, you know, as an industry or a CCP led solution, we are happy to see if that develops.

On the issue of relief, I think one of the things to consider is that, you know, a lot of people or a lot of people in the industry may have entered into these transactions with a certain amount of assumptions about, you know, the clearinghouse positions. If you change that and these things all end up being not cleared, I wonder if participants have to factor in the other associated issues, like capital and other things that happen, you know, from cleared versus non-cleared considerations. And, obviously, there is the margin issue as well. So, you know, the issue of relief from margin, again, on uncleared or legacy swaps has, you know, been previously discussed in the subcommittee and the larger MRAC as well.

So I think this issue certainly needs a lot more thought and debate before we kind of jump to a regulatory ask for exemptions.

CHAIRPERSON ZAKIR: Thank you, Bis. That is helpful. And I think we tend to agree as well that there is quite a bit of work that we still need to do in the context of swaptions.

You know, we do think that the subcommittee could very well be a very good forum for that discussion to occur and for there to be solutions, especially given that there may or may not be a need at some point in time, you know, for further action from the Commission as well. So, certainly, I think that would be something that we would like to continue to observe and evaluate.

Our next question here, Marnie Rosenberg, JPM?

MS. ROSENBERG: Yes. It is going to Tom's two questions. Yes, we do think there is potential valuation differences on these products. That will be an issue for our firm and all firms that trade swaptions and that result in physically settled swaps.

We do think that this is still an emerging issue that needs to be sorted out. There could be multiple solutions. And we think it is premature to request for no-action relief from clearing the physically traded swaps.

We also think that it would be best if market experts who trade swaptions in their respective firms have a forum to sort these out, what the potential solutions are and the pros and cons of each. My understanding is there have been discussions about setting up a subcommittee under the ARRC under the Market Structure Working Group to handle this. And we would be supportive of that and then potentially coming back to the Benchmark Subcommittee with the results of those discussions and then making a determination as to what the recommendations could be that would be put forth to the full MRAC and the CFTC.

Thank you.

CHAIRPERSON ZAKIR: Thank you, Marnie.

Stephen Berger, Citadel?

MR. BERGER: Thank you.

So I think I will be echoing some of what we have heard from a few of the other responders, but yes, we do see potential valuation differences here. And so

I think this is an issue that does warrant further attention. I think it is good that the subcommittee is bringing this up for dialogue. Whether it is the exactly appropriate venue to weigh in I think is an open question, but it certainly is doing a good job by drawing attention to the issue of providing some thought leadership here.

So I don’t know if the subcommittee could organize some sort of consultation where the market experts could weigh in or whether it is through the working group, the ARRC Market Structure Working Group that was just mentioned, but I do think we need to have, you know, people who are trading these products day in and day out involved in the discussions. And I know they have got folks who are willing to do that.

And at this point, I think I agree with what some of the other commenters said, that I think it is, at a minimum, premature, if not just not advisable in the end to seek, you know, clearing relief in this instance. So, you know, we think that that would potentially fracture the market, create some risks of cherry-picking in terms of who takes the cleared versus uncleared swap at exercise and would create challenges with respect to hedging the products if we are going down the uncleared route.

So, anyway, we look forward to continuing to engage on finding the right solutions here.

CHAIRPERSON ZAKIR: Thanks, Stephen.

Lee Betsill, CME Group?

MR. BETSILL: Oh, hi. Thanks.

Yes. I just wanted to go back to the question that was raised I believe by Calpine at the beginning of this discussion topic in relation to using margins in exchange for potential sticks or I suppose carrots in incentivizing through. I just wanted to make the comment that, generally speaking, we see an appropriate margin or margins as being, you know, reflective of the actual risk solutions and liquidity in those markets. I am not sure that it is appropriate to use that as an incentive or a stick.

I would say that if we see liquidity in LIBOR, those contracts, it would be incentive maybe. And, of course, that would be reflected in our margin setting. So I just wanted to make that general comment.

CHAIRPERSON ZAKIR: Thanks, Lee.

If there are no further comments or issues for discussion on this topic, Tom, could you please discuss the subcommittee’s next steps?

MR. WIPF: Yes. Thank you, Nadia.

I think the subcommittee obviously will -- our work will continue after this meeting. And we intend to have another update for this group at the November MRAC meeting. Just to recap what we have seen here today and heard here today, given the MRAC’s approval of the plain English disclosures earlier, you know, we hope that -- and that gets passed on to the CFTC. It will be helpful to make that accessible to market participants in short order. Again, I think there is, you know, a real belief among the subcommittee that having many, many bespoke disclosures is probably not helpful. And to the extent that this plain English disclosure is helpful for market participants broadly, we think that would be a positive and sooner, rather than later, on that and when they are posted on the CFTC site and supplementary information will be posted on the ISDA site when all of that takes place.

In terms of the discussion on coordination between the clearinghouses, I think we heard very clearly from the subcommittee as well as what we have heard on this call that there is a great desire for consistency. I think what we need to contemplate is our takeaway is have further discussions on where that could actually take place and what is the best venue, again, that would have, you know, major focus on potential antitrust issues but also being very focused on what we have heard of the financial stability issues in terms of getting this process as most consistent as possible.

For the swaptions discussion, I think we have heard loud and clear that there is more work to do. I think we can take that back to our group. We can, you know, really work on this, but certainly I suspect that knowing that the ARRC is also focused on this, we will also refer to our original guidance from Commissioner Behnam that our group here is to be additive and not to duplicate work. So we will ensure that whatever, wherever this lands and wherever this topic gets the best focus and the best chance for a reasonable outcome, we will stay very close to that. In the meantime, I think we -- that one is a little bit too early to report back on, but I think we have heard pretty clearly that it is an issue.

It needs to have some form of resolution. There are a couple of ideas out there, but we will be very certain to stay very, very close to the ARRC on this one and ensure that, again, our work from our subcommittee is additive to that and accretive to that work if, in fact, it takes place at the ARRC.

From there, I think, you know, we have got plenty to work with there. We will reconvene the subcommittee and take this all back. Again, our big open question is where could the -- what is the appropriate venue that the clearinghouses could actually have productive discussions around this call for consistency that we have heard here today from the subcommittee and from those who spoke up on the call. Besides that, I think we have got plenty of takeaways.

And we again thank everyone for joining this off-cycle call and the opportunity to actually put this all together. You know, we thank Commissioner Behnam, Alicia, Nadia, the subcommittee, MRAC, and all involved in this and everyone at the CFTC. Thank you very much.

And I will pass back to you, Nadia.

CHAIRPERSON ZAKIR: Many thanks to you, Tom, and your leadership as well as members of the subcommittee, and including Matt Ochs, for your hard work. We certainly look forward to hearing more about the subcommittee’s efforts at our next meeting.

This concludes the business part of the agenda.

MS. LEWIS: This is Alicia Lewis. Before we go to closing remarks, I would like to get those members who may have joined the call late on the record as having attended. So Isaac Chang, AQR?

MR. CHANG: On.

MS. LEWIS: The lines are open. Isaac, are you on?

MR. CHANG: Yes, I am on. Sorry. Yes.

MS. LEWIS: Okay. Thank you.

Annette Hunter? Unmute your phone, Annette.

Annette Hunter?

(No response.)

MS. LEWIS: Well, Annette has indicated via email that she is, in fact, on the call. However, we cannot get her on the record right now.

Laura Klimpel, DTTC?

MS. KLIMPEL: Yes, I am on, Alicia.

MS. LEWIS: Thank you. Yes, we got you.

MS. KLIMPEL: Thank you.

MS. LEWIS: Kevin McClear, ICE?

MR. McCLEAR: Yes. Hi. Thanks.

MS. LEWIS: Thank you. Marcus Stanley?

(No response.)

MS. LEWIS: Okay. Well, those were the individuals who we wanted to get on the record. Well, it is now time for closing remarks from Commissioner Behnam.

COMMISSIONER BEHNAM: Thanks, Alicia.

I really don’t have much else to say other than reiterating what Tom said in his closing. Tom, thanks again for all of your leadership as chair. This is great work. Special thanks to Alicia and Nadia for their continued contributions and organization.

I want to thank the CFTC tech team who is in front of me right now. These meetings are always a little bit tricky, but they pulled it off really well. And thanks to Ann, Agha, and Dennis for your contributions to all of the questions.

For everyone on the committee and the subcommittee, we are fast approaching 2020. And the months and weeks are going by. This is a huge issue. These are small pieces of a larger puzzle that I think these contributions will have a tremendous value add as we work closer to 2021. And as Tom said and I said repeatedly, we are working with our colleagues in both the official sector and the private sector to make this as seamless as possible and be a value add to the larger ARRC contribution.

So with respect to the disclosures and the discounting adjustments and the swaptions, I think we heard a lot of consensus, a lot of great questions, which hopefully the subcommittee will take back and work from and create better work products down the road.

Lastly, I just want to thank my fellow commissioners who are here. And I have heard a lot over the summer as we have had a transition. You know, I know the new chairman is thinking about LIBOR extensively. And as he gets settled, I know we are going to start to respond to some of the regulatory relief that was requested last year and some of his larger policy priorities and how we as the Commission are going to address these very challenging issues.

But we are here. We are available. And we understand the import of all of this and the fact that we are a part of this exercise and need to be working with you and making sure that we are providing appropriate guidance and making sure that the market's transition is smoothly and in a transparent, safe, and well-functioning way.

So thanks again to everyone for your time and look forward to future conversations.

MS. LEWIS: Thank you, Commissioner Behnam. I want to thank everyone for attending this meeting and also give a friendly reminder that the nominations for the Climate-Related Market Risk Subcommittee are due today and should be submitted to the MRAC submissions email address set forth in the Federal Register release.

And this meeting is now adjourned. It is 4:26.

MR. WIPF: Thank you.

(Whereupon, at 4:26 p.m., the meeting was adjourned.)