COMMODITY FUTURES TRADING COMMISSION

Global Markets Advisory Committee Meeting

9:15 a.m. EST

Thursday,

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TELECONFERENCE

PARTICIPANTS

CFTC COMMISSIONERS

Commissioner Dawn D. Stump (GMAC Sponsor)
Chairman Heath Tarbert
Commissioner Brian D. Quintenz
Commissioner Rostin Behnam
Commissioner Dan Berkovitz

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A G E N D A

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A G E N D A (CONTINUED)

A G E N D A

P R O C E E D I N G S

(9:16 a.m. EST)

MS. GOLDSMITH: Thank you very much. Good morning everyone. As a Designated Federal officer for the Global Markets Advisory Committee, it is my pleasure to call this meeting to order.

I'd like to welcome everyone to today's meeting. This is the fourth meeting under the sponsorship of Commissioner Stump and the second and final of 2020. In light of the global response to the COVID-19 pandemic, we are holding today's meeting as a virtual meeting to protect the safety of agency personnel, GMAC members, guest panelists, and the public.

To ensure that today's meeting goes as smoothly as possible, there are a few logistical items that I need to mention. Because this is a virtual meeting, it is also being broadcast in a live stream on the internet, so please be sure to identify yourself before speaking. Also, please signal when you have completed your comments, so that we can continue with the next speaker or question. Please ensure that your phone is unmuted before you start to speak, that you speak clearly into your phone, and that you re-mute your line when you are done speaking.

For GMAC members and Commissioners, if you would like to be recognized during the discussion, please use the WebEx chat icon on the bottom of the screen, select the “All Panelists” option within the drop down menu, indicate that you have a comment or a question and press enter. If any meeting participant needs assistance during the call, please dial star-zero to connect to the conference operator or message me directly within the WebEx chat.

Finally, please keep your telephone line muted when you are not speaking. If you do not mute your line, the conference operator may need to mute it for you.

I'd now like to turn things over to the GMAC sponsor, Commissioner Dawn Stump, for her opening remarks.

COMMISSIONER STUMP: Good morning and welcome to the final Global Markets Advisory Committee meeting of the year.

This is Dawn Stump and I would like to begin by thanking Chairman Tarbert, and my fellow Commissioners for attending today's meeting. I also want to recognize that due to the global nature of this committee, there are many members and panelists participating in local time zones that may be less than convenient, and I'm extremely grateful for their willingness to do so.

I would especially like to thank all of today's esteemed presenters for being here and for taking the time out of your busy schedules. And in the case of Takashi for joining us during your overnight hours to contribute to today's important discussion.

Additionally, I would like to thank Chair Angie Karna for her leadership of the GMAC and Andree Goldsmith, the GMAC Designated Federal Officer, for organizing today's meeting.

As the year comes to a close, I also want to take the opportunity to recognize the specific contributions of this committee to the CFTC’s work. During your last meeting we focused on the need to better align our global regulatory expectations for margin requirements on transactions not subject to central clearing. Since then the Commission has acted on a number of the related recommendations received from this committee and continues to consider other elements of the report you submitted, from your Subcommittee on Margin Requirements for Non-Cleared Swaps. This is but one indication of how important your work is here to informing the Commission, and for that we are grateful. To all of those who serve on each of the CFTC advisory committees and subcommittees, I just wish to say thank you.

Having devoted the last GMAC meeting to properly calibrating the regulations of non-centrally cleared derivatives, today we will shift our focus to advancing clearing in the global derivatives market.

The first panel will focus on regulatory developments affecting the global clearing system. August Imholtz and Abigail Knauff from the CFTC’s Division of Clearing and Risk will present on the CFTC’s recent rulemaking concerning registration with alternative compliance for non-U.S. derivatives clearing organizations. Then Patrick Pearson, Head of Financial Market Infrastructure at the European

Commission, will discuss the finalization of EMIR 2.2, and in particular, the regulation framework for supervision of third country CCPs.

And Takashi Nagaoka, Deputy Commissioner for International Affairs at the Financial Services Agency of Japan, will discuss Japan's interest in the CFTC providing an exemption for CCPs to be able to offer clearing services to U.S. clients.

These three presentations will together highlight the importance of mutual recognition of comparable comprehensive regulatory frameworks for supervising central counterparties around the world. We will reflect on the progress we have made to-date and what more can be done to advance the shared goals of increasing central clearing for derivatives.

During our second panel, four presenters will look back at global derivatives clearing over the course of 2020, with a particular focus on the impact of the COVID-19 pandemic.

First, Nick Rustad, Chairman of the Board of Directors of FIA, will present a clearing members' perspective on CCP margin requirements during the market volatility caused by the pandemic. We will then hear from representatives of two CCPs on their respective experiences during the pandemic: Sean Downey, Executive Director of Clearing, Risk, and Capital Policy at CME Group, and Dmitrij Senko, Chief Risk Officer at Eurex Clearing.

To wrap things up, Sayee Srinivasan, Deputy Director in the Division of Clearing and Risk at the CFTC, will present a regulator’s perspective on CCP margin practices during the recent market volatility.

I'm hopeful that these presentations will contribute to the ongoing dialogue regarding lessons learned from the market volatility earlier this year, so that global clearing systems can remain resilient in the face of future market stresses. I'm very much looking forward to today's presentations, and again I want to thank all of our panelists for being here to further these important conversations pertaining to global derivatives clearing.

That concludes my opening remarks, I'll turn it back to Andree. Thank you.

MS. GOLDSMITH: Thank you Commissioner Stump.

Chairman Tarbert.

CHAIRMAN TARBERT: Thank you Andree and I am very pleased to be here today to address this group.

This may be, I think, my last GMAC meeting, at least as Chairman. So it's wonderful to be here with all of you today. Over the last 17 months, the CFTC has set and met some very ambitious goals. And we did all of that while managing the fallout of COVID-19, which has changed the way all of us work and collaborate.

Many of our achievements, and this is the point of my remarks today, have actually been built on the great work of GMAC, as well as Commissioner Stump’s leadership. So I want to sincerely thank you, Commissioner Stump, for your vision and commitment. You have made the GMAC an important part of our success. In fact, as Commissioner stump mentioned, you know, several of our policymaking successes in the last 12 months alone have drawn on the ideas that are discussed right here at the GMAC.

So, for example, GMAC has taken up and we'll talk about today, some important international issues, including the implementation of EMIR 2.2, and of course, I'm pleased to say that we have made great progress on that issue. And we've greatly benefited from this committee's insight and insights in doing that and I can honestly say that I think our relationship with Europe and other countries around the world is stronger today than it's ever been. We've been able to reach what I think is a truly win-win resolution.

GMAC has also advanced our thinking on the issue of exemptions from registrations for DCOs, or clearinghouses, which we actually turned into a final rule last month. And I'm confident that this committee will continue to be an important voice on that topic, as well as on related matters of equivalence and substituted compliance.

And then finally, as Commissioner Stump mentioned, we've benefited greatly from GMAC’s insight into the implementation and phasing of the uncleared margin rules, your recommendations on the scoping and implementation, the subcommittee report, were especially helpful. Not only in generating ideas, but actually allowing us to translate those ideas into final rules.

So like those before it, today's meeting is sure to advance more important ideas, particularly involving CCPs, clearing, and related issues affecting our global markets. And again, I just want to thank everyone on the GMAC for your service for providing that. It's critically important for a financial regulatory agency, such as us, to be able to listen and really glean insights from all of our key diverse stakeholders. So thank you very much.

MS. GOLDSMITH: Thank you Chairman Tarbert, Commissioner Quintenz.

COMMISSIONER QUINTENZ: Thank you Andree and thank you for your leadership from the staff perspective of GMAC, and of course, thank you to Commissioner Stump. The agendas of these meetings have been profound, very well put together. And as Chairman Tarbert said, has a direct and positive impact on our policymaking.

It's one thing to hold a meeting and to discuss various issues, it's another thing to organize them over a long-term perspective on topics of critical importance to the agency and the markets and have those discussions actually inform what we do as a Commission. And I just really like to thank her for her leadership and vision there.

With regards to today's agenda, I am very much looking forward to hearing all the presentations, these are issues that are close to my heart. I know they're very, very close to Commissioner Stump’s heart as well as the rest of our Commissioners and our Chairman, and highlighting the -- what I think is very positive progress that has been made on the issues of deference surrounding CCP recognition, examination, resiliency, while we also acknowledge that our regime is based off of intermediaries and infrastructure and registration.

I think it's important to understand how we can view that regime in the context of making sure we provide access to U.S. clients to the best liquidity pools possible.

So I appreciate the balancing act that we may hear more about today, and I’m very much looking forward and thanks again for the opportunity to join you.

MS. GOLDSMITH: Thank you Commissioner Quintenz.

Commissioner Behnam.

COMMISSIONER BEHNAM: Thanks Andree, and good morning to everyone on the GMAC. It's great to be with you. I’m looking forward to today's discussion. And of course, thanks to Commissioner Stump for her leadership and convening the meeting today, as we end off the year Andree thanks to you, of course, as the Designated Federal Officer and also thank you to Angie Karma for her chair and her leadership of the committee.

You know, really just kind of repeating what has been said already, but it's been great to see the GMAC convene over the past 12 months and really bring thoughtful recommendations to the Commission which we have taken action on. I think everyone's benefited from that.

And regarding today's agenda, as challenging as the early months of this year have been from a market’s perspective and certainly dealing with the COVID pandemic from a work and personal perspective over the past few months as we emerge, hopefully, in the next few months and into 2021. I think we all at least, some of us feel very confident that markets responded well, but certainly I think today's discussion will help us as we evaluate lessons learned and think about what we can do better for next time.

So a very important discussion, and important timing to kick it off now as we end 2020 and look into 2021. As always, to do better and build more strong resilient markets which, of course, will benefit everyone who's a part of this discussion today.

So thanks again to everyone and I look forward to the discussion.

MS. GOLDSMITH: Thank you Commissioner Behnam. Commissioner Berkovitz.

COMMISSIONER BERKOVITZ: Thank you, Andree. Good morning, good afternoon, or good evening to everybody depending on where one may be located.

I'm very pleased to be here today, also, I will echo the sentiments expressed by my fellow Commissioners about the productivity and the great work that this committee has done. And I’d just like to note that I really think the way this committee has operated and the Commission's consideration of the committee's recommendations and the recent regulatory action we took based on those recommendations, really reflects excellence, I think, in government decision-making and public participation. In my mind, this is really the way to develop sound regulations with a strong consensus for that approach.

The GMAC really represents a wide variety of expertise and experience and wisdom in the operation of our markets globally, and took the time, made recommendations to the Commission in a public meeting. We put those recommendations out for public comment, received public comments, deliberated in a collegial fashion, and now within the space of a relatively short timeframe, particularly in government decision-making time, we were able to make those improvements to our regulations in the time of a COVID pandemic when there are all sorts of other priorities as well.

So I think this is really -- I thank the committee for their participation. And I'd particularly like to thank Commissioner Stump for her leadership in making this happen from working with the committee on the agenda, the committee to providing recommendations that are really useful to the CFTC and really further the objective of harmonization and liquidity in global markets. That benefits not only the U.S. markets, but the markets globally.

And without Commissioner Stump's efforts in this regard, it wouldn't have happened. So Commissioner Stump, thank you for your leadership. And Angie Karna and Andree Goldsmith, thank you for your leadership in making this happen as well.

So I'm looking forward to today's discussions and presentations. Thank you.

MS. GOLDSMITH: Thank you, Commissioner Berkovitz. Thanks again to all the Commissioners for taking part in this meeting, and for sharing your remarks with the GMAC.

Before we begin with our presentations today, I would like to do a roll call of GMAC members on the phone so that we have your attendance on the record. After I say your name and firm, please indicate that you are present. Please don't forget to unmute your phone in order to speak.

Chris Allen, Standard Chartered Bank.

MR. ALLEN: Yes, I'm here.

MS. GOLDSMITH: Tedd Backer, Morgan Stanley.

(No response.)

MS. GOLDSMITH: Ashley Belich, RBC Capital Markets.

MS. BELICH: Present.

MS. GOLDSMITH: Shawn Bernardo, TP ICAP SEF.

(No response.)

MS. GOLDSMITH: Darcy Bradbury, D.E. Shaw and Co.

MS. BRADBURY: Here.

MS. GOLDSMITH: Maria Chiodi, Credit Suisse Securities LLC.

MS. CHIODI: Here.

MS. GOLDSMITH: Clive Christison, BP.

(No response.)

MS. GOLDSMITH: Joe Cisewski, Better Markets.

(No response.)

MS. GOLDSMITH: Jim Colby, Coalition for Derivatives End-Users.

(No response.)

MS. GOLDSMITH: Gerry Corcoran, R.J. O'Brien and Associates.

(No response.)

MS. GOLDSMITH: Sunil Cutinho, CME Clearing.

(No response.)

MS. GOLDSMITH: David Goone, Intercontinental Exchange, Inc.

MR. GOONE: Here.

MS. GOLDSMITH: Paul Hamill, Citadel Securities.

MR. HAMILL: Present.

MS. GOLDSMITH: Amy Hong, Goldman Sachs.

MS. HONG: Present.

MS. GOLDSMITH: John Horkan, LCH.

MR. HORKAN: Present.

MS. GOLDSMITH: Adam Kansler, IHS Market.

(No response.)

MS. GOLDSMITH: Angie Karna, Nomura Securities International, Inc.

Angie, I didn't hear you. I'm not sure if you have unmuted.

(No response.)

MS. GOLDSMITH: Bob Klein, Citigroup.

MR. KLEIN: Yes, I'm here.

MS. GOLDSMITH: Agnes Koh, Singapore Exchange.

(No response.)
MS. GOLDSMITH: Ben MacDonald, Bloomberg LP.
MR. MacDONALD: Present.
MS. GOLDSMITH: Erik Tim Müller, Eurex Clearing AG.
MR. MÜLLER: Present.
MS. GOLDSMITH: Joe Nicosia, Louis Dreyfus Company.
(No response.)
MS. GOLDSMITH: Murray Pozmanter, DTCC.
(No response.)
MS. GOLDSMITH: Tom Sexton, National Futures Association.
MR. SEXTON: Present.
MS. GOLDSMITH: Jessica Sohl, HC Technologies.
MS. SOHL: Present.
MS. GOLDSMITH: Thane Twiggs, Cargill Risk Management.
(No response.)
MS. GOLDSMITH: Supurna VedBrat, BlackRock.
MS. VEDBRAT: Present.
MS. GOLDSMITH: Masahiro Yamada, JP Morgan

Securities.

MR. YAMADA: I’m present.

MS. GOLDSMITH: Great, thank you. If there were any GMAC members who were unable to indicate your presence on the call, please email me or message me directly in WebEx to confirm your attendance for the record.

With that I'd like to turn the program over to Angie, GMAC Chair, for an introduction of our presenters on panel one.

(Pause.)

MS. GOLDSMITH: We seem to have -- we seem to be having a little bit of trouble hearing Angie, so why don't I go ahead and announce the first presenters and during that presentation we'll get the technology straightened out.

Just a few logistical reminders before the presenters start. Please keep your phones on mute while you're not speaking. Following the presentations there will be an opportunity for GMAC members and Commissioners to ask questions and discuss the presentations. If you would like to be recognized to speak, please use the WebEx chat icon on the bottom of the screen. Select “All Panelists,” indicate that you have a question and press enter. Please identify yourself and your firm prior to speaking and indicate when you are finished speaking.

The first item on the agenda is a series of presentations on regulatory developments to advance global derivatives clearing. Our first panelists will be Abigail Knauff and August Imholtz, who are both Special Counsel in the Clearing Policy Branch in the Division of Clearing and Risk at the CFTC.

Ms. Knauff and Mr. Imholtz will present on the CFTC’s rulemaking concerning alternative compliance for non-U.S. derivatives clearing organizations. Please go ahead.

MR. IMHOLTZ: Good morning Commissioner Stump, Chairman Tarbert and Commissioners Quintenz, Behnam, and Berkovitz. My name is August Imholtz, I’m an attorney in the Clearing Policy Branch of the Division of Clearing and Risk. My colleague, Abigail Knauff who’s also an attorney in the Clearing Policy Branch in DCR, and I will provide the GMAC with an overview of the Commission's recent rulemaking, registration with alternative compliance from non-U.S. derivatives clearing organizations.

In this rulemaking, the Commission amended its regulations to provide a second registration option for non-U.S. DCOs that clear swaps for U.S. persons, including for FCM customers, if those DCOs meet certain eligibility criteria. Prior to this rule which became effective on November 20th of this year, the CFTC requirements did not distinguish among registered DCOs based on whether they are organized within or outside of the United States. Non-U.S. DCOs were subject to the same requirements in the Commodity Exchange Act and the Commission regulations that govern U.S. DCOs. This illustrates one of the two primary considerations that were fundamental in driving this rulemaking.

First, the Commission recognized the existence of regulatory overlap. Non-U.S. DCOs were required to comply with both the U.S. regulatory regime and the regulatory regimes in their home countries.

Second, the Commission also recognized that there are significant differences in the extent to which non-

U.S. DCOs clear swaps for U.S. persons. To address the circumstances, the Commission added to its regulations a new registration and compliance framework in Subpart D to permit a non-U.S. DCO to register with the Commission, yet comply with the DCO core principles through compliance with its home country regulatory regime, subject to certain conditions and limitations.

Next slide please.

A non-U.S. clearing organization that is applying for registration as a DCO subject to alternative compliance will be eligible if the clearing organization is in good regulatory standing in its home country, a memorandum of understanding or similar arrangement is in place between the Commission and the clearing organization's home country regulator, the Commission determines that the clearing organization's compliance with its home country regulatory regime will satisfy the DCO core principles in the Commodity Exchange Act, and the clearing organization does not pose a substantial risk to the U.S. financial system.

Next slide please.

The Commission may determine that a non-U.S. DCO poses substantial risk to the U.S. financial system, if that DCO holds 20 percent or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt DCOs and 20 percent or more of the initial margin requirements for swaps at that DCO is from U.S. clearing members.

Where a DCO is at or near the 20 percent threshold, the Commission has discretion as to whether the DCO would or would not be eligible for alternative compliance. The substantial risk test uses the term U.S. clearing member, which means a clearing member of a non-U.S. DCO that is either an FCM or organized in the United States, or a non-U.S. entity whose ultimate parent company is organized in the U.S.

A bit of background and context about the substantial risk test. The first prong is designed to address systemic risk. The Commission's primary systemic risk concern arises from the potential for loss of clearing services for a significant part of the U.S. swaps market in the event of a catastrophic occurrence affecting the DCO.

The second prong of the test is intended to respect international comity by ensuring that the substantial risk test captures only those non U.S. DCOs with clearing activity attributable to U.S. clearing members sufficient to warrant more active oversight by the Commission.

Overall, the substantial risk test is designed to better calibrate the Commission’s oversight of Non-U.S. DCOs, based on the principle of deference to their home country regulators, while at the same time, taking into consideration risk to U.S. clearing members and ultimately risk to the U.S. financial system.

For context, of the 15 DCOs currently registered with the Commission, five are organized outside of the United States. But only three would be eligible to pursue registration under the alternative compliance framework. One of those five clears futures traded on a DCM, and the other is one of the largest DCOs in the world, and is likely to pose a substantial risk to the U.S. financial system.

So now that I've discussed the purpose of the registration with alternative compliance framework, and which DCOs are eligible to register as a Subpart D DCO.

I'm going to turn the presentation over to Abigail to discuss the regulatory requirements and procedures for the alternative compliance framework, beginning with the next slide.

Next slide please.

MS. KNAUFF: Thank you, August. This slide gives a high level comparison of the requirements for DCOs registered under the original registration framework and the alternative compliance framework. There are two notable differences.

First, while all registered DCOs are subject to the DCO core principles in the CEA, a Subpart D DCO is able to comply with the DCO core principles through compliance with the applicable legal requirements in its home country. A Subpart D DCO does not have to comply with each of the Commission's implementing regulations in Subparts B and C of Part 39. A Subpart D DCO, however, must comply with all of the conditions in its order of registration.

The second notable difference is that the Commission has exempted Subpart D DCOs from the rule submission requirements in Part 40, with the exceptions of rule filings related to customer protection and swap data reporting rule changes.

All registered DCOs must comply with the Part 45 swap data reporting requirements. Next slide.

Additionally, as shown in the previous slide, all registered DCOs, including Subpart D DCOs, must comply with the Commission's customer protection regime, which includes Section 4d(f) of the CEA, parts 1 and 22, and section 39.15 for the treatment of funds.

U.S. customers must clear through FCMs at a Subpart D DCO, and all DCOs, including Subpart D DCOs, must comply with the CEA and Commission regulations, which are designed to protect the safety of funds and assets belonging to clearing members and their customers.

Next slide.

An applicant’s registration under the original registration framework must file numerous and extensive exhibits. The Subpart D DCO applicant will only need to file a select list of exhibits. The most notable exhibit is the regulatory compliance chart, in which an applicant would state the citation and full text of the home country regulator’s applicable legal requirements, and an explanation of how the applicant complies with each DCO core principle.

If the home country regulatory regime lacks legal requirements that could correspond to a particular DCO core principle, the applicant will need to explain how it would satisfy that DCO core principle.

Next slide.

An order of registration for a Subpart D DCO will contain certain conditions. First, as discussed previously, the DCO must comply with the statutory DCO core principles, the Commission's customer protection regime, the Part 45 swap data reporting requirements, the general DCO provisions in Subpart A of Part 39, all the requirements in Subpart D of Part 39, and the conditions in this list.

Second, DCOs must comply with the open access requirements to treat swaps with the same terms and conditions as economically equivalent, allow offset to the extent permitted at the DCO, and provide non-discriminatory clearing for swaps executed bilaterally or on unaffiliated platforms.

The third condition, a DCO must consent to the U.S. jurisdiction and designate, authorize and identify an agent for service of process in the U.S. and promptly report any change of its U.S. agent.

Fourth, a DCO must comply with and demonstrate compliance with any condition upon the Commission's request. A DCO must also make all books and records open to inspection and copying by a Commission representative, including promptly making these books and records directly available to the Commission.

Fifth, the Commission must receive a written representation of good regulatory standing from the DCO’s home country regulator within 60 days of the DCO’s fiscal year end.

And finally, the Commission may add other conditions, based on any other facts and circumstances it deems relevant. The Commission will consider the degree of deference that the home country regulator extends to the Commission's oversight of U.S. DCOs in determining whether to extend the benefits of alternative compliance to the DCOs in that jurisdiction.

The Commission will consider this degree of deference both initially when registering a Subpart D DCO, and when determining whether compliance under the framework should continue.

Next slide.

Subpart D DCOs have periodic and event-specific reporting requirements, as shown here, and these DCOs must provide any other information that the Commission deems necessary, including but not limited to information for the Commission to evaluate the DCO’s continued eligibility as a Subpart D DCO, review the DCO’s compliance with conditions in the order of registration and conduct oversight of U.S. clearing activity.

The event-specific reporting requirements are more limited than requirements for DCOs registered under the original registration format framework.

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Finally, the Commission codified procedures to permit it in its own discretion, and upon its own initiative, to modify the terms and conditions of a Subpart D DCO’s order of registration, if there are changes to or omissions in the facts or circumstances pursuant to which the order was issued, or if any terms and conditions of the order have not been met.

For example, if the DCO fails to remain in good regulatory standing, poses a substantial risk to the U.S. financial system, or the home country regulatory regime no longer satisfies the statutory DCO core principles, the Commission would provide notice to the Subpart D DCO of its intention to modify the order of registration.

This concludes our prepared remarks on the registration with alternative compliance framework. I note that in addition to adopting this final rule this fall, the Commission also codified its existing approach to exempt DCOs, whereby a non-U.S. DCO is permitted to clear only proprietary swaps for U.S. persons.

August and I are happy to answer any questions about the rules during the Q&A. Thank you.

CHAIR KARNA: Thank you, Ms. Knauff and Mr. Imholtz, and apologies for the technical issues earlier.

Our second panelist is Patrick Pearson, Head of Financial Markets Infrastructure at the European Commission, who will present on the finalization of EMIR 2.2, and ESMA's engagement with the CFTC on EMIR 2.2. Please go ahead, Mr. Pearson.

(No response.)

CHAIR KARNA: Mr. Pearson, are you on the line?

(No response.)

OPERATOR: Mr. Pearson if you're on, please press star-zero. Mr. Pearson, your line is now open.

MR. PEARSON: Thank you very much and apologies for the glitch. Can you hear me?

CHAIR KARNA: Yes, we can. Thank you, Mr. Pearson.

MR. PEARSON: Thank you very much. I'd like to thank, first and foremost, Commissioner Stump, for the kind invitation to speak. I think this has been my fourth or fifth GMAC over the past years and they've always been a very helpful and welcome opportunity for the European Commission to speak on these important matters.

I've been asked to say a few words about our recent regulatory efforts on regulating third country DCOs. And, like the CFTC, we in the European Union have been looking at how to consider risk posed by non-EU DCOs operating on our markets, if they pose risk, which risks, and what would be the consequences. And all of this against the backdrop of deference, very important for global markets with global actors and global business.

The first thing we did was to look at whether systemic risk could arise from non-EU DCOs operating in our markets. And in doing that, we immediately looked at which risks we would think would be relevant. And we picked up about eight or nine, eight or nine specific risks that we listed as potentially relevant in determining if a DCO from outside of Europe would operate in our markets that we'd need to take into account.

The first is the nature of the transactions. The complexity, the risk profile, the maturity of those transactions that are offered in the European Union.

The second element we looked at was what would the effect of a failure or disruption of a third country

DCO be on the stability of the European Union's financial markets. We also looked at the structure of a DCO’s clearing membership, how transparent is it, how diverse is it. We looked at the extent to which, importantly, a DCO’s clearing would involve trades denominated in the Euro, or in other Union currencies for member countries in Europe that aren't part of the Eurozone like Poland or Sweden.

We looked at whether there would be alternative DCOs offering similar services to those offered by a non-EU DCO in the European markets. And finally, we looked at how exposed would EU participants and EU clients be to a DCO from a third country. Now a whole list of incredibly complex issues that we needed to consider.

So how did we go about this? Well, the first thing we did was we reached out to fellow regulators across the globe. We spoke to our colleagues in many jurisdictions. I think it's quite fair to say that we spent quite a considerable amount of time with our colleagues in the CFTC. The reason for that is that the colleagues in the CFTC in parallel to our efforts have been looking at, essentially, similar issues. How do non-U.S. DCOs pose risk to your markets and your system in the U.S.?

So, we have had lots of conversations. We both learned, and we both listened. And I think it's fair to say that, certainly, in our regulation that was published this summer, you can even pick up the fruits of those bilateral conversations we had with many regulators and also with those in the CFTC.

Let me give you a few examples. The first thing that we learned, and that was confirmed to us by colleagues in the CFTC, was that when you look at risk in your markets there are some risks that do not objectively pose financial stability risk in your own market. And you will find that very important principle in our law, where we specifically refer to the fact that agricultural products listed and executed on what we call regulated markets in third countries, which largely serve domestic and non-financial counterparties, are not transactions that pose significant risk. I think we even use the words, they pose negligible risk to the clearing members and the trading venues in the European Union.

So that's something very, very, I think, prominent that we picked up quite early on in our discussions with our colleagues in the CFTC.

But then the second and third issues that we picked up, a good example is that we learned very quickly after intense discussions with colleagues in the CFTC that it's one thing to put the regulation out there in which you try to determine what financial stability risks are. And it's another to try and apply and implement that to the participants in the markets. Because what the participants in the markets are looking for is transparency. And the best way to achieve that, we learned from the CFTC, was through quantitative indicators, quantitative thresholds.

You have your 2020 rule -- we didn't copy that rule, but we certainly went home to Europe with a very clear understanding that that's the only and the best and the most propitious way to regulate.

And that's why, what we did introduce in our own rules is a series of quantitative indicators. Quantitative thresholds, if you will, to determine exactly when a DCO from the third country would objectively pose a systemic risk in the European Union.

We decided to look at four specific indicators. We decided to look at the amount of open interest in securities transactions.

We decided, secondly, to look at the maximum notional outstanding of derivative transactions or swap transactions as you call them, denominated in Union currencies.

We also needed to look at the average aggregated margin requirements and default fund contributions for accounts held at the third country DCO by European Union clearing members, obviously to measure and to mitigate external risk for our banks and other clearing members.

And finally, we wanted to look at the largest payment obligations that had been entered into by Union entities. These were very, very clear -- we think -- indicators, and useful indicators for us to measure risk and to determine whether a third country DCO would be of systemic importance to us in the European Union or not.

And why is that important? It's important because we have a very simple system in our rules and regulations in Europe. If you are not systemically important, you are what we would call a Tier One DCO. In essence, nothing changes. The full panoply of deference of European Union rules will continue to apply to a DCO from that jurisdiction: full mutual recognition, full deference, no change essentially to the current supervisory approach. It's business as usual.

However, if we do determine at a DCO from the third country that does hit one or more of those quantitative thresholds, then you could be determined as a Tier Two DCO, which is a systemically important DCO. And that has significant consequences, because that means that the systemic importance that that DCO poses to our financial system brings with it a number of requirements and a number of rules and agreements that need to be in place for that DCO to continue to operate in the European Union.

It even can go further than that if you are Tier Two and you meet further specific requirements. You can enter into a system of Tier Two-Plus DCO regulation, in which there are even stricter requirements, possibly, including a possible requirement for European participants to only clear certain trades with a DCO established in the European Union.

So that's how we’ve set about this, and I must say and, in all honesty, the many conversations with the CFTC, with Chairman Tarbert, with the Director of International Affairs, Mr. Suyash Paliwal and Mr. Tom Benison from the Chairman's Office over the past year or so, actually guided us in European Union to come up, together, with comments from other regulators, to a system that we think is fair, that is transparent, and that is equitable as well.

Those open and collegial cooperation discussions that we've had, I think that I am also confirmed in this, have led us to the conclusion in the European Union that on the basis of those objective indicators, that we have not been able to identify a U.S. DCO as being of systemic importance for the European Union. Operationally that simply means that U.S. DCOs will continue to operate on and our markets with full deference as before.

And I think what Chairman Tarbert and Mr. Suyash Paliwal and Mr. Benison have applied is a wonderful principle. We have a mutual love of William Shakespeare. And as we all know, he once wrote “Love all, trust a few, and do wrong to none. All’s well that ends well.”

So, that is the key element of our legislation that was published over the summer. Now, that legislation needs to be operational. And in order to do that, the European Commission has set up a new and a separate supervisory authority within the ESMA framework that will apply and implement these rules and requirements and will be the talking point for third country regulators, including the CFTC.

Now, the new chairman of that group, Mr. Klaus Loebler is unable to join us today. He has a board meeting with ESMA in Paris, but he's certainly asked me to pass on the message that he is open for business, and he is really looking forward to continuing a very good and helpful working relationship with the CFTC.

I think my 10 minutes are up and I'll stop there, Commissioner Stump.

CHAIR KARNA: Thank you very much Mr. Pearson.

Our final panelist for panel one is Mr. Takashi Nagaoka, Deputy Commissioner for International Affairs at the Japan Financial Services Agency. Please go ahead. Mr. Nagaoka.

MR. NAGAOKA: Thank you very much, Commissioner Stump for a very kind introduction. Good morning to everybody.

First of all, I would like to thank the CFTC for inviting me today to the renowned Global Markets Advisory Committee meeting and providing me with the opportunity to speak about CCPs' cross-border supervision and deference.

Before starting my presentation, I'd like to touch upon the usual but important disclaimer, i.e. the views and opinions expressed in this panel discussion are those of myself and do not necessarily reflect the official policy or position of JFSA. Now, let me begin.

Due to the COVID-19 pandemic, we experienced an extremely volatile market this past March, and this in turn has allowed us to reconfirm the importance of the role CCPs play within the financial system. And while steps to make CCPs more resilient continue to be discussed internationally, I believe that from a cross-border supervision perspective, CFTC’s recent rulemakings, including that on the exempt DCO are very important and crucial work.

And today I'd like to speak about a few points, or maybe slightly diverging from what Commissioner Stump has kindly introduced, but they will be the ongoing international discussions on market fragmentation and some of the initiatives in Japan, as well as the topic of the U.S. investors’ access to the Japan market in relation to exempt DCO.

So, let me first explain a bit on what is currently being discussed internationally regarding market fragmentation. Many of the participants may be well aware of the subject already, but in any event, let us have a look at this important development again.

Going back a few years under the Japanese Presidency of 2019 G20, we included addressing market fragmentation as one of the priorities in the G20 finance track, and FSB and IOSCO published reports respectively on this particular issue in mid-2019. This in turn has created the momentum for FSB and IOSCO to review how the rules and restrictions created by different jurisdictions are contributing to the market fragmentation and how we will be approaching this issue going forward.

As part of such an initiative, IOSCO’s market fragmentation follow up group, which Japan currently co-chairs with Quebec AMF, was tasked to review and identify good and sound practices regarding deference of regulation and supervision between jurisdictions, and publish the report in June this year.

The concept of deference has been viewed as an effective way to mitigate market fragmentation. But the review process is often time consuming and at times lacks transparency and clarity. The good and sound practices provided in the published report would provide useful clues for relevant authorities to improve the processes for deference determinations by making them more efficient.

The report carries huge significance in that it provides a direction and momentum in terms of fostering common understanding and mutual cooperation among authorities, and thus avoiding market fragmentation that could cause undue burden and undermine market efficiency.

Now, with that, I would like to discuss some of the initiatives in Japan in relation to foreign CCPs. Japan currently has a two-tier system for allowing foreign CCPs to operate their clearing business in the Japanese financial market. In principle, foreign CCPs are required to obtain a license prior to their operation. However, there is also an exemption system where foreign CCPs may be exempted from licensing itself, subject to the condition that default of the trailing transactions would have a minor impact on Japan's capital market.

Both channels are designed so as to take into account deference to the home regulator’s regulation and supervision over the foreign CCPs and avoiding regulatory overlaps, which may become a barrier for the foreign CCPs to enter.

With respect to the licensing system, requirements applicable to foreign CCPs are much more lenient compared to the requirements for domestic CCPs. In particular, foreign CCPs are exempted from the minimal capital requirements, nor do we require them to set up a physical office within Japan.

As mentioned in a previous part of my speech, such a treatment is described as one of the effective approaches for cross-border regulation in the IOSCO's report on market fragmentation published in June last year.

On the exemption from licensing, or the exemption system. We made some revisions in June this year, reflecting the discussion at the international fora. In short, while the exemption status used to be reviewed every six months, this revision -- this time around, allows the exemptions to be granted without time limitation, subject to an additional condition that cooperation arrangements with relevant competent authorities of the third country have been established. This change was welcomed by market participants as it offers stability and predictability for risk management purposes and is expected to facilitate smoother cross-border transactions going forward.

This exemption system was also referred to in IOSCO's report, "Good practices on processes for deference," published this June. Currently, U.S. CCPs provide their CDS and repo clearing services to Japanese investors under this exemption system. Under this two-tier system, we granted a license to Eurex in March this year.

In the midst of persisting uncertainties pertaining to Brexit and COVID-19 pandemic, this new licensing was well-received by market participants, especially from a risk mitigation perspective.

In the same context, the revision of the exemption system based on the deference to the foreign CCP's home jurisdiction was also welcomed by the market participants as it made it easier for them to use the foreign clearing system for managing their risks with added stability.

As you can see on taking into account the discussions at the international fora, our regime for foreign CCPs has been updated and, subject to home regulator's cooperation, offers enhanced accessibility to markets. The update aims to provide market participants with broader choice in terms of risk management, without compromising financial stability. We also expect it to stimulate fair competition among CCPs for the benefit of investors, including improvement of the quality of services and cost reduction, among others.

Now I would like to briefly touch upon the recently finalized exempt DCO rule in the U.S. I understand that upon finalization of the exempt DCO rule by CFTC last month, Chairman Tarbert has expressed his support on continued discussion on whether to permit exempt DCOs to clear certain non-U.S. dollar denominated swaps for U.S. customers. And I would expect that such discussion will continue.

I believe that our mission as regulators, is to maintain financial stability and ensure customer protection while enhancing better market access by investors through avoidance of harmful market fragmentation. On that basis we welcome following consideration by the CFTC on this issue, and its future rulemaking processes.

Japan is very much looking forward to working with CFTC and other authorities to accomplish our mission to create open --

(Unmuted participant interruption.)

MR. NAGAOKA: I'll stop here. Thank you very much.

(Unmuted participant interruption.)

CHAIR KARNA: As a reminder, if you're not speaking, could you please put your phones on mute -- we’re getting some --

MR. NAGAOKA: Thank you. That concludes my presentation.

CHAIR KARNA: If a GMAC member or Commissioner wishes to speak, please use the WebEx chat icon at the bottom of your screen and select “All Panelists” as your option within the drop down menu.

Well, to start us off in the presentations we heard a discussion of how the U.S. and the EU have approached regulatory deference when it comes to the supervision of CCPs outside their jurisdictions, as well as similar feedback from Mr. Nagaoka.

In your view, are the varying approaches to regulatory deference sound? Do they go far enough in allowing a home country regulator to take the primary role in supervising the CCPs in their own jurisdiction? And that's a question for all panelists, as well as anybody else who has any feedback from the Committee.

MR. KLEIN: Chairman Karna, this is Robert Klein at Citigroup. I have a comment and some questions if I could be recognized.

CHAIR KARNA: Yes, please go ahead, Mr. Klein.

MR. KLEIN: Thanks. First of all, I mean in response -- I was gratified to hear the reminder from Mr. Nagaoka that as part of the exempt DCO rules, and as part of Chairman Tarbert’s comments on those rules, there is at least an opportunity for further discussion around client access to exempt DCOs. And I'd like to note that Citigroup is certainly aware of significant interest by U.S. institutional clients in accessing Japanese yen denominated swaps clearing, in particular on JSCC. So we would certainly encourage the CFTC, the JFSA, and the JSCC to continue their dialogue, to see if there is a practical and safe avenue for permitting

U.S. client access to exempt DCOs.

So in that spirit if I can continue, I do have a couple of questions from Mr. Nagaoka.

CHAIR KARNA: Yes, please go ahead, Mr. Klein.

MR. KLEIN: Okay. I guess, you know, the JSCC has certainly advocated for U.S. person access to clearing in Japan under an exempt DCO route. But one of the factors that's been a concern, as I understand it, is whether client margin posted by U.S. clients into Japan would receive protection that is equivalent to the U.S. protections if that margin were held by JSCC clearing firms.

The JSCC, I think, has asserted that their segregation model should provide the equivalent or better protection for clients. And my question is, is there a way that the JFSA and the CFTC could work together to get the U.S. regulators comfortable with how the Japanese client money protection regime works, and the level of protection that it would afford to U.S. clients were they to clear on JSCC?

MR. NAGAOKA: May I respond?

CHAIR KARNA: Yes, please go ahead, Mr. Nagaoka.

MR. NAGAOKA: Thank you very much, Mr. Klein, for your question. It is important to consider protection of U.S. customers' assets from events such as a failure of clearing members of an exempt DCO when thinking about U.S. customers' access to clearing outside the U.S., and under the Japanese regulation, client margin is separated at the clearing member level, as well as CCP level.

I think you're familiar with it already, from the JSCC's explanation, but that's the basics.

The regime is complemented and reinforced by JSCC's relevant rules of enforceability supported by the Financial Instruments and Exchange Act, that's the security law in Japan. And compliance with the requirement for segregation is monitored by the regulator, ourselves, as well. And the law also clearly provides for a preferred claim in bankruptcy in the event of a failure of a clearing member.

So, collectively, I think there is sufficient protection for the U.S. clients.

And I will not go into details of our regime here but we are happy to discuss further with CFTC to help, having a better picture of mutual regulatory and supervisory frameworks, where it is common and where there are differences and how those differences could be filled in.

If the private sector has any specific issues meeting qualification, apart from the questions just, we had from Mr. Klein, we'll be happy to receive such inquiries, as well, either directly or through CFTC. And I would like to repeat that we will be very much happy to discuss further with CFTC on the qualification studies needed. Thank you.

CHAIR KARNA: Thank you Mr. Nagaoka. Mr. Klein, do you have any follow up before I go to the next question?

MR. KLEIN: I have one follow up question.

In Europe, we've seen one example, Eurex, which has attained a full DCO registration with the CFTC in offering essentially parallel clearing models. Again, a question for Mr. Nagaoka, or others. What's the biggest hurdle for JFSA or JSCC to support a full JSCC registration as a DCO as opposed to looking at the exempt DCO avenue?

MR. NAGAOKA: Thank you, Mr. Klein again for a good question, and I must say that I'm not so familiar with the two parallel clearing models employed by Eurex, and cannot actually make any comparisons based on that.

But in general, when we talk about entry of foreign CCPs, we need to look at differences in the legal systems of respective jurisdictions with regard to, for example, segregation of customer assets and bankruptcy procedures, among others, which form the basis for supporting the clearing model. And I'll refrain from making guesses here because we don't really have a specific picture in front of us, but going forward if JSCC comes to consider application for full DCO in the new environment with the new exempt DCO rule in place, and if the CFTC as a home regulator is welcome to discuss it, we, the JFSA will be happy to work with them on the matter and then identify what actually is the hurdle and how we could actually overcome those hurdles.

So, it is not something that we foresee in the future, but sorry I cannot really have a clear response at this point. Thank you.

CHAIR KARNA: Thank you Mr. Nagaoka. Ms. VedBrat, do you have some comments to add to the discussion?

MS. VEDBRAT: Yes. First of all, I'd like to thank the panelists for the hard work that they have done in bringing you know some light to this very important topic and for the Commission to bringing this to the GMAC as an important discussion topic.

You know, so what I'd like to do is give a little bit of perspective on, you know, the topics that we discussed, keeping in mind the end client or the end investor. As a fiduciary, BlackRock wants to be able to access the highest quality of CCPs that offer the best liquidity for our end clients. And to that, you know, end we do favor policies that enable healthy competition among high quality CCPs in different jurisdictions. We’re also highly encouraged by the work that regulators have done to consider common international standards on CCP supervision, recovery, and resolution, given the global nature of our, you know, markets in general.

The one piece that, you know, we just want to be able to highlight is that local policies that may artificially fragment markets, they will potentially lead to higher costs. And, you know, ultimately, you know, could lead to greater risk, you know, for clients. And so, if we could just, you know, keep that in mind as we are defining local regulations.

The other thought that I would like to make a comment on is our discussion on the alternative compliance, you know, while we don't necessarily feel that this will make a material impact on our clearing strategy, we already have access to many non-U.S. domiciled CCPs such as LCH and Eurex that are fully registered and regulated by the CFTC. But as -- you know, my fellow panelists have highlighted, you know, access to the JSCC, you know, is something that we all want to work towards making much more seamless for, you know, for the U.S. client.

You know there's been, you know, migration of liquidity from LCH to the JSCC CCP which has essentially, you know, created a basis between, you know, the offerings on both the CCPs and as a result, you know, this could create a competitive disadvantage for U.S. customers. You know, and it may also, you know, make it less efficient to be able to hedge, you know, the risk.

So that's something that, you know, we would we would encourage, you know, more dialogue, so that we're able to, you know, make it accessible to the U.S. customers in a much more meaningful way.

And then my last comment is, you know, regarding the Tier Two Plus designation, that, you know, we may see some of, you know, some of the CCPs being deemed. The, you know, there is a little concern that this could dampen market competition and client choice. You know, it could actually increase in a different type of systemic risk, due to like forced migration and fragmented, you know, market liquidity and, you know, to some extent, it can also, you know, lead to an increased cost to the end client due to slipping, you know, of margin models and potential migration costs.

Thank you, back to you.

CHAIR KARNA: Thank you very much Ms. VedBrat.

Mr. Cutinho, do you have some comments to add to the discussion?

MR. CUTINHO: Yes. Can you hear me?

CHAIR KARNA: Yes we can. Thank you.

MR. CUTINHO: Okay. I think I just have a comment, but I don't have any questions.

I'd like to take this opportunity to thank the CFTC and the European Commission for working together to achieve mutual recognition the second time around, as well as achieving a level of deference, and I think this is a balanced approach. We strongly believe in that, because the laws in each one of the jurisdictions are never the same. And it can result in significant conflicts between international regulations and local laws. So, I think that we've done quite a bit since the global financial crisis in creating standards bodies and regulators all around the world, whether they're prudential regulators as well as market regulators, work together to establish the standards.

So to the extent that each regulation adapts to standards to the local laws, then deference is the most practical, pragmatic and the best way moving forward.

So thank you and I yield my time.

CHAIR KARNA: Thank you very much Mr. Cutinho.

Mr. Yamada, do you have any comments to add to the discussion?

MR. YAMADA: Yes, thank you. First off, I wanted to echo those thanks. We definitely applaud the close relationships the CFTC has developed over the course of Chairman Tarbert's tenure here, and believe that, you know, the progress we've made to really enshrining the regulatory principles of deference and equivalence have been tremendous. And clearly are -- the fact that we've got such strong global presence on the panel here is evidence of that progress.

The one point I would make, particularly around the topic of global consistency and coordination. We -- you know, I'm sorry, I lost my train of thought here.

The progress is clearly -- or the proposals here clearly do help enshrine the principles of safety and soundness of the system. There are still a few points mentioned by our Citi colleagues, where there's a little bit of room for improvement here. In particular -- I’m sorry.

CHAIR KARNA: Mr. Yamada, are you still on the line?

(No response.)

CHAIR KARNA: Mr. Yamada, did we lose you?

(No response)

CHAIR KARNA: All right, hopefully we'll get Mr. Yamada back in a minute, but in the meantime does anyone else have any questions or comments for our panelists?

COMMISSIONER STUMP: Hi, Angie. This is Commissioner Stump. I just wanted to ask, among the committee members if anyone might like to discuss for the benefit of those who may not be aware or even the benefit of the Commission, the manner in which we've distinguished clearing for the clearing requirements for CCPs abroad with regard to OTC swaps, as opposed to futures.

I just think that might be worthwhile if there's anyone on the committee who might like to speak to that. And if not, that's fine too, but since we have a few minutes here I just thought I would ask if anyone on the committee might like to address the manner in which we handle foreign CCP recognition with regard to clearing futures and how we've handled that in the past.

MR. KLEIN: This is Bob Klein, I mean I can provide a little bit of information. If that would be helpful.

CHAIR KARNA: Yes, that would be great Mr. Klein, please go ahead.

MR. KLEIN: Thank you. And thank you for the question, Commissioner Stump.

There is a distinction, as I'm sure you and the staff are well aware. In the futures side, there are two ways that U.S. clients can access non-U.S. clearing houses. And those two methods have existed for quite some time now.

The first is to establish a clearing relationship with a U.S. FCM that has a effectively a correspondent or indirect clearing relationship with a member of the non-U.S. CCP and clears the client trades through that correspondent, or indirect clearing relationship, in which case the U.S. FCM will hold the customer funds subject to Part 30 of the Commission's rules, which has a bankruptcy protection and other requirements that are analogous but not exactly the same as those for segregated funds held for margin on fully regulated DCOs.

The second method is that in some instances, the Commission has granted what amounts to an equivalency determination for certain foreign regulators, including some foreign CCPs, and under those so-called Part 30 determinations, U.S. clients can deal directly with a non-FCM member of the foreign CCP provided that that member falls within the Part 30 equivalency determination and the U.S. client would then establish a direct relationship with a non-U.S. clearing firm, post margin to that non-U.S. clearing firm and be fully subject to the non-U.S. regulatory requirements that the Commission has deemed to be equivalent.

So that's quite a bit different from the cleared swaps area where effectively there is no permitted indirect clearing unless all clearing members in the chain are FCMs and clients cannot access clearing on a non-U.S. CCP unless that CCP is fully registered as a DCO, and permits FCMs to become members.

COMMISSIONER STUMP: Thank you Mr. Klein.

CHAIR KARNA: Yes, thank you very much Mr. Klein.

Commissioner Stump, did you have a follow up? I have a couple of other people who want to provide some feedback as well.

COMMISSIONER STUMP: Well, I do have a follow up, and Bob you can take this one or you can ask one of the other clearing members in the group to take it. You've done a great job of describing the distinctions that have been made with regard to OTC and listed futures and the manner in which we as the regulator have enabled access in those different formats.

I would be interested to know if the FCMs who are engaged in utilizing Part 30 to enable their clients to access clearinghouses abroad, that are not registered with the CFTC, they must have some mechanism by which they disclose to their client that they may or may not be protected under the U.S. Bankruptcy Code. And while I'm not making any statements about whether or not they are protected under the U.S. Bankruptcy Code, I would be curious as to how FCMs handle that today as they maybe perhaps disclose to clients what is -- what may or may not occur in the event of a bankruptcy at a CCP abroad, on the listed side.

MR. KLEIN: This is Bob Klein. I'm happy to take a shot at that, but would welcome input from other firms.

I think on the listed futures side, again, they're -- given the fact there are two models, if clients are documenting with an FCM and using what I'll refer to as an indirect clearing methodology, there is in fact disclosure that's provided by FCMs of the relevant risks in dealing in foreign markets. However, the client funds are in fact protected under Part 190 of the Bankruptcy Code, they're just protected as what are referred to as secured funds rather than segregated funds.

Where the client chooses to deal directly with a non-U.S. firm that is a member of the CCP in reliance on a Part 30 equivalency determination, that disclosure is governed by the relevant rules of the local markets. And I think it varies from case-to-case and clients, you know, have to evaluate what disclosures they're getting and what kind of, you know, what kind of information they feel they need.

But I’m happy to hear comments from other clearing firms.

MS. CHIODI: Hi, this is Maria Chiodi. If I may join Bob?

CHAIR KARNA: Yes, please go ahead, Ms. Chiodi.

MS. CHIODI: So on top of that, back in 2014-ish or so, the CFTC promulgated the enhanced profit protection rules. So to bolster some of the protections for Part 30 like residual interest, et cetera. But I think what Bob described was, you know, again, not commenting on the Bankruptcy Code -- I’m not a bankruptcy lawyer, you know, if you're dealing with the FCM, you are within the CFTC’s Part 190 and U.S. Bankruptcy Code as a client. A U.S. client that clears directly with a non-U.S. clearing firm, then not so much, you are completely outside of the Bankruptcy Code, if that make sense, in the U.S. anyway.

CHAIR KARNA: Thank you Ms. Chiodi.

Ms. VedBrat, do you have some insights on this question?

MS. VEDBRAT: Yes. You know, I just, you know, wanted to add a little bit from a risk perspective, you know, as we look at the markets both the, you know, for indirect clearing through our U.S. FCMs. You know, it's very important to see what type of risk you're bringing into your clearing relationship.

Like for us, you know, what we try to do is, you know, obviously, we will make sure that the FCMs that we are engaging with, you know, have a, you know, robust risk management methodology, but, you know, the other component of it that, you know, we focus on is making sure that for markets where we do require indirect clearing, we encourage our FCMs to have more than one relationship, you know, for that indirect clearing, because there are elements of indirect clearing, that is passed on to the end client, and you want to be able to avoid a situation where that -- if that indirect clearer for whatever reason, isn't able to clear, you're not in a situation that you know you're unable to either clear your transactions, or de-risk, you know, if you hold positions, you know, something that we have observed in the past.

That's, you know, something that, you know, the Commission could take, you know, into consideration is to have, you know, requirements of more than one indirect relationship.

CHAIR KARNA: Thank you Ms. VedBrat.

Mr. Cutinho.

MR. CUTINHO: I think Bob did a wonderful job of covering the perspective of members. I have only very little to add, but as a fact, the CFTC does provide full recognition and deference when it comes to futures for foreign boards of trade, as well. So there is no registration required for the underlying clearing organization, as long as it belongs to a jurisdiction that the CFTC recognizes as equivalent.

And there is a registration, of course, but it's a different form of registration but it is at contract market level, and not at the clearing level.

CHAIR KARNA: Thank you Mr. Cutinho.

Mr. Yamada.

MR. YAMADA: Yes, apologies for the glitch earlier.

I would reiterate that it does feel like the FCM model, which is effectively an omnibus model, does seem to be an effective and somewhat proven template upon which we could address many of the concerns that the representative from Japan, and some of the issues that they were looking into.

There is a model for this and it appears to be somewhat proven, and obviously it worked through the recent turmoil. So perhaps this would be something for further investigation, as a potential model for some of the issues that have been mentioned.

CHAIR KARNA: Thank you, Mr. Yamada.

Mr. Müller.

MR. MÜLLER: Yes, thank you very much. Erik Müller, Eurex Clearing.

I would like to also make a comment if I may.

CHAIR KARNA: Yes, please go ahead.

MR. MÜLLER: I'd like to also congratulate the CFTC and the EU Commission for reaching their accord on this subject matter.

I think as pointed out by Sunil, one of our fellow peers, there is a difference, indeed, in the way we can register as a foreign board of trade versus the registration process for OTC IRS clearing that we are a fully licensed DCO in that area. And that I think is still -- there's a difference to being a Tier One EU

CCP, and obviously the obligations under the full DCO, certainly, but I think also under the under the alternative route that is presented today.

So I think it's still sort of not a 100 percent level playing field, but in practice, I think the CFTC has been very reasonable in effecting the theoretical rights that there are under the full DCO, so we feel it's something that in practice we can well live with and therefore are grateful that these topics could be resolved in a way acceptable to both jurisdictions. So for us it's certainly a basis to be able to operate. That's my first point.

The second point I think where further work ought to be done is, and maybe nothing that the CFTC can directly help with, but something that's important. If these non-U.S. CCPs have access to U.S. clients. Then, of course, the strong preference of these U.S. clients is also to pledge U.S. collateral, which often comes in the form of U.S. dollar cash.

So the foreign CCPs, even if fully registered as a DCO, today have no ability to place these funds in the most secure way, which would be in a Fed account. And that is a route that's available to many of the U.S. CCPs, but not to the foreign CCPs, and I think in terms of systemic risk mitigation and stability of global markets, this would be something to consider for the future, and I think the CFTC has been helpful in identifying this point and again it's something for the broader policy agenda but important.

CHAIR KARNA: Thank you very much Mr. Müller.

Does anybody else have any final questions or comments before we move on in our agenda?

MR. HORKAN: Yes, this John Horkan from London Stock Exchange Group, could I add a comment?

CHAIR KARNA: Yes, please go ahead Mr. Horkan.

MR. HORKAN: Thank you. Thank you for organizing today and Commissioner Stump for leading the GMAC and all the Commissioners in the CFTC for really your guidance and your support, and certainly what I think all can know is a unprecedented year.

As a clearinghouse that is registered directly in multiple jurisdictions globally, I want to first applaud the CFTC and the EU on their cross-border cooperation. I think it's critical, we think it's critical. And the principles that we think should be supported are ones of deference, reciprocity, and open access. And we think the goal of all those should be, you know, safe and efficient markets, and importantly a level playing field across all jurisdictions for people to participate in, and ensure the safe functions of the markets.

So I just wanted to add that comment from a clearinghouse that is directly registered in multiple jurisdictions and it's important that regulatory cooperation continues to help the markets perform well.

CHAIR KARNA: Great. Thank you very much, Mr. Horkan.

Before we move on to the next item on our agenda, I'm going to turn it back over to Andree to do an update on the roll call.

MS. GOLDSMITH: Thanks Angie, just wanted to note several GMAC members who are present and on the call, but who we could not hear during the original roll call. So, present on the call are Ted Backer from Morgan Stanley; Clive Christison, BP; Joe Cisewski, Better Markets; Jim Colby, Coalition for Derivatives

End-Users; Gerry Corcoran, R.J. O’Brien and Associates; Sunil Cutinho, CME Clearing; Adam Kansler, IHS Market; Agnes Koh, Singapore Exchange Limited; Murray Pozmanter, DTCC; and Thane Twiggs, Cargill Risk Management.

Thanks Angie, go ahead.

CHAIR KARNA: Thank you very much. We will now move on to the second agenda item for this morning, which is a series of presentations on the impact of the coronavirus pandemic on global clearing. We will start with a presentation from Nick Rustad, Chairman of the FIA Board of Directors. Please go ahead, Mr. Rustad.

MR. RUSTAD: Hello, can everybody hear me okay?

CHAIR KARNA: Yes, we can. Thank you.

MR. RUSTAD: Excellent. Thank you. And thank you Commissioner Stump for the opportunity to speak today, and to the Commissioners and GMAC members in attendance. For those who do not know me, my name is Nick Rustad, and I'm Chairman of the Board of Directors of the Futures Industry Association, but I'm also Head of JP Morgan's Derivatives Clearing Business.

If we can move on to the first slide, please.

At the end of October, the FIA issued a paper providing a clearing member view of the March volatility in clearing. I'll be summarizing much of that paper in my remarks today. The review was global and not targeted at any one jurisdiction. Not all CCPs had the same issues and some already have in place some of the recommendations it made.

In March, we saw historic volatility outpacing even the volatility seen during the 2008 crisis. The good news is that the cleared derivatives market withstood the shock. In fact, central clearing and other post-crisis reforms helped ensure mitigation of credit risk and improve counterparty risk management. CCPs remained genuinely resilient, both from an operational and technological perspective.

But March did provide a real world stress test, and allowed us to see if there's any room for improvement. In our opinion, there is.

The crisis exposed significant unintended consequences in some CCPs’ initial margin models, particularly for exchange-rated derivatives. They can be summarized into three areas. The procyclicality of

CCP margin requirements contributed to the overall level of stress in financial markets, the steep and rapid increases in CCP initial margin requirements created funding pressures on FCMs and their clients, and unscheduled intraday margin calls are hard to predict and sometimes not transparent, making it hard to plan for in advance.

A number of regulators and global standard setting bodies have issued reports on the March volatility which touched on this subject. Most recently, the FSB put out a report on the March market turmoil which noted that regulators will undertake further work on margin frameworks in 2021, which we welcome, and we look forward to engaging on. We hope the FIA’s work can contribute to these efforts.

I thought it'd be helpful to start with a quick review of what happened during the spring volatility. FIA used data from CPMI-IOSCO’s quarterly public quantitative disclosures from nine CCPs to estimate the impact. Four are based in the U.S., four in Europe, and one in Japan. These nine CCPs collected a detailed wide range of contracts in both OTC and ETD markets across interest rates, equities, foreign exchange, credits and commodities. The aggregate amounts of initial margin at these nine CCPs rose from $563 billion at year-end to $833 billion at the end of the first quarter.

This data is only reported quarterly, but that's a 48 percent jump in margin during the first three months of 2020. Next slide please.

This data is presented graphically on this slide. You can easily see the jump in initial margin at the end of Q1. A quick note on the data. The time series begins in 2015, because this is when CCPs began publishing this data. We do not have comparable data from the global financial crisis of 2008.

Next slide please.

This chart is based on the same data as a previous slide, but we've presented the data in a different way so that you can see the variations across CCPs. The chart shows the total level of initial margin for the three most recent quarters available, taking a more granular view shows that the increase in initial margin levels varied across CCPs, which reflects the differences in asset classes, contract types, and margin models.

Next slide please.

This chart is based on data published monthly by the CFTC on the total amount of customer funds held in futures accounts of futures commission merchants regulated by the CFTC. As the chart shows, the amount of customer funds hit a record in March 2020. In fact, the increase in that one month was more than $100 billion.

That increase is the single largest month increase in the history of this data and exceeded even the increase in customer funds during the financial crisis of 2008. The size of this increase shows of pressure on customers to locate large amounts of additional collateral and deposit with their FCMs and to do so in an unusually short period of time.

Just a quick note on this data. The amount shown here is the required segregated funds as defined by the CFTC, and do not include excess deposits from the FCMs.

Next slide please.

A common question is whether this increase in margin held at CCPs is caused by an increase in client positions or open interest, or by the scale of increase in individual contract levels of margin. Based on the information we have available I would argue it is likely to be the latter.

Slide seven shows monthly aggregate open interest and the increases in positions is barely noticeable on this chart in the way that it was on the previous charts showing margin. In fact, positions with open interest remained fairly constant for the first half of the year.

Next slide please.

In my opening statement I highlighted the FIA review was global, and the next few slides will show this issue is not limited to a single jurisdiction, CCP, or asset class.

Let's start with the equity indices with the three benchmark contracts in the U.S., Europe, and Japan.

The S&P, the level of margin almost doubled from $6,600 per contract to $12,000 a contract. The Eurostoxx 50, it did more than double. However, this does not tell the full story. What these numbers disguise is that the value of the contract is falling at the same time. If you want to look at margin as a percentage of the value of the contract, the S&P went from 3.9 percent to almost 11 percent. The Eurostoxx 50 went from 6.9 percent to almost 20 percent of notional.

If we scan through the next couple of slides you see that this is not just limited to equities. The next few charts show similar trends in fixed income and in commodities, where CCPs needed to adjust margin models to reflect the possibility that the price of oil could, and did, go negative.

Next slide please.

So why do individual contract margin rates, and by extension the aggregate amounts of margin held, have to increase at the rate it did? Quite simply, it's because the levels of margin set were inadequate for the market environment we found ourselves in.

This slide shows the numbers of futures contracts where the daily move exceeded the margin held against that contract. To use the example of the S&P 500 contract earlier, if the margin was 3.9 percent, then we are classifying a breach as a one day move greater than 3.9 percent. You can see how the number of margin breaches reported by the nine major clearing houses varies from 3,106 during the 12 months ending in Q4, to 6,640 in the 12 months ending Q1 2020.

In other words, the number of margin breaches that occurred in Q1 alone was greater than for the total for the 12 preceding months. This is one of the reasons why we refer to the first half of 2020 as a stress test of the clearing system. When there are shortfalls in initial margin, the first line of defense has been breached. If a client can not meet the resulting margin call within a short period of time, we begin moving through the waterfall of the default management process.

Each clearing member is responsible for the risk they bring, but that does not diminish the need to ensure that appropriate levels of margin set for the industry as a whole are appropriate. Clearing members manage risk client-by-client, clearing houses manage the risk of the broader market. It is very important to note that margin models are not designed and should not be designed to cover all market movements in all market scenarios.

Margins are calculated at a 99 percent confidence interval. In plain English, that means we should expect two to three margin breaches per contract per year. Of course, there were more breaches than that during March.

Before I finish this review of what happened and move on to suggestions for improvement, it is worth reflecting on one more thing. All of the examples I've given refer to listed derivatives. I’ve barely mentioned how OTC market models behaved in this period. This is because breaches were larger and more frequent for exchange-rated derivative contracts relative to over the counter contracts, and at CCPs with lower margin periods of risk, with lower confidence levels, that controlled procyclicality by capping margin increases, and that clear less liquid contracts.

The five-day regulatory minimum MPOR for OTC contracts means that OTC margins remained more stable. In contrast, exchange-traded derivatives margin started from a lower base; hence, they are subject to a higher and more procyclical margin increase under the stressed conditions.

The next two slides try to reflect this graphically by showing the upper and lower boundaries of margin for an OTC derivative, and its equivalent listed derivative contract, in this case, a 10-year interest rate swap and a 10-year U.S. Treasury bond future. Both happen to have margins set by the same clearing house.

Our purpose is to show the differences in how margin models treat OTC and ETD products that present very similar levels of risk.

We move on to the next slide, to the bond future.

The green line at the top, and the dark gray line at the bottom, and mirror images of each other. We include both in our analysis to show a maximum coverage for both losses and gains, the scatterplot in the middle shows the mark-to-market change in contract value on a daily basis from mid-February to mid-December.

As you can see, on the U.S. Treasury futures chart there are several blue dots outside the boundaries of margin coverage. These are margin breaches that took place in February/March. You can also see the adjusted margin was -- sorry, you also see the move and adjusted margin requirement was very rapid during that period, and continued to keep the requirements at a relatively high level at the start of the year.

If we flick back to the same analysis of the 10-year interest rate swaps, you can see the initial margin requirement was much higher relative to daily P&L, and there were no margin breaches.

It is clear the amount of margin required for over-the-counter interest rate swaps is much higher than ETD. One reason is the difference in the margin period of risk for OTC is generally five-days compared to two-days, one-to-two days for the exchange-rated derivatives. This is only one example. But having a look at the recalibration and margin models is one option to look at.

Slide 14, which I'll skip over in the interest of time -- go one more up please. Thank you. Shows this across a number of contracts, but as I said, I'll move on to the margin of time.

If we move on to Slide 15, thank you. Initial margin undoubtedly should have risen during this period of time and the FIA is not arguing at all about this. CCPs must increase margin to cover risk. However, we do believe the level of margin increases during the spring volatility was too great, and therefore margin either started too low or ended up too high.

One solution to these steep increases in margin could be by setting appropriate floors, so margin doesn't fall too low during quieter times. Multiple floors operate the same, and we believe this situation calls for review of floor methodologies to see if they are robust or could be strengthened.

Next slide please.

Of course, we understand that margin is not intended to cover 100 percent of the risk, so a balance must be struck but in setting the floors. I've just discussed how different products and jurisdictions have different standards for margin periods of risk and confidence levels.

We recommend a principles-based approach. The look back period should be long enough to include a variety of market environments and always include periods of significant market stress. Floors should be calibrated for specific contracts and asset classes. Margins should be calibrated based on analysis of the absolute and percentage returns in order to set floors that are both adequate in low and high price regimes.

We acknowledge this could lead to an increase in the level of margin funding during BAU market conditions and recognize that there is a balance to be struck to ensure that incentives to clear are not diminished. But arguably these costs exist today and are currently covered through large default funds, which coincidentally saw a decrease as margin levels increased during the crisis.

Incentives to clear already exist in part due to the levels of margin required under the uncleared margin rules brought in post-2008. Next slide please.

We also strongly recommend that margin frameworks must be back-tested to test the potential for large and sudden increases in margin requirements. This testing would be in addition to the back-testing margin sufficiency that is done now. This means defining a maximum rate of change over a predefined period of time and then testing whether a stress test would cause the margin to exceed those defined parameters. If it does, the margin framework should be adjusted.

The frame -- next slide. The framework for intraday call should also be revisited. Margin which is collected intraday can be both initial margin and variation margin, but tends to typically be variation margin. CCPs must be able to call for additional funds intraday to maintain sufficient collateral. However, it's important to note that intraday calls can increase funding pressures and therefore clearing members keep buffers for funding needs intraday.

CCP requests funding within 60 minutes and clearing members usually fund those without immediately requesting collateral from clients. In many cases, clients are based on the opposite side of the world and this would be highly impractical. At some point during the spring volatility, members were called more than six times for intraday margin.

For OTC derivatives, any intraday margin calls require the clearing member to run a residual interest calculation before we can release funds to the clearinghouse. This is a tight turnaround time.

Although CCPs can share high level details around their IM methodologies, there is not full transparency. FCMs cannot replicate IM moves with precision, so the transparency is at best described as partial. FCMs can only approximate funding requirements. Some CCPs use ad hoc calls more routinely, but they should only be used during severe market moves.

CCPs call for intraday losses but do not pay out gains, creating liquidity stress. This variation margin is particularly a challenge if a market were to reverse intraday as you get no benefits from the margin has already been posted. Variation margin should be zero sum across the system, and therefore should not impact overall market liquidity. However, practice with some CCPs and not paying out intraday gains whilst calling for losses invalidates this construct and adds strain to the system at precisely the time unnecessary strain is most unwanted.

Some calls are required to be met in cash and come late in the day. Regulatory requirements around holding excess and bank diversification rules means that it's hard to pull funds back from safe sources. Some CCPs do not allow intraday funding to be applied against an end-of-day requirement, resulting in further double funding. Failure to recognize end-of-day amounts that have essentially been prepaid seems a technical oversight that can be easily addressed and would help alleviate unnecessary strain of the system.

Last slide please.

Therefore, we offer some specific solutions to these issues. We recommend the following best practices around intraday calls including routine intraday calls to be made at the same time every day. This would be easier operationally for what is currently a very manual process. Calls should clearly separate initial margin and variation margin. This would allow clearing members to cover intraday initial margin calls with non-cash collateral.

Ad hoc intraday calls should be used on a limited basis, perhaps once a clearing member’s specific threshold has been exceeded, and CCPs should provide full transparency of triggers for calls.

In conclusion, we look forward to dialogues such as this one with Commissioner Stump, and equivalent meetings, such as the one organized today. We look forward to discussing what should be best practices around CCP margin to lessen procyclical impacts going forward. Thank you.

CHAIR KARNA: Thank you Mr. Rustad.

The second presentation will be from Sean Downey, Executive Director of Clearing, Risk, and Capital Policy at CME Group. Please go ahead, Mr. Downey.

MR. DOWNEY: Well, thank you and I just want to confirm that you can hear me.

CHAIR KARNA: We can, thank you.

MR. DOWNEY: Great. So first I wanted to thank the Commissioners and CFTC staff in particular, Commissioner Stump for hosting this event, and Andree Goldsmith for coordinating the meeting. I know this has been a difficult year for everyone. I'm honored to have the chance to present on this important topic.

So before I get into the slides, I just wanted to make three quick points on some views on the overall year that we had. So first, I'd like to say that CME

Clearing certainly agrees with the notion that central clearing performed very well during the COVID pandemic stress, just as it has historically during past stress.

Also I wanted to note, when you think about antiprocyclicality of CCP margins, the goal of antiprocyclical measures is to mitigate the size and the speed of increases in margin in response to changing market conditions, with the goal being to avoid causing or exacerbating financial instability.

Based on this, we are going to focus the majority, although not exclusively, on the aggregate margin changes, and our portfolio coverage levels throughout this time period.

Finally, I just want to note that this has been noted in the past but this is a once in a century pandemic. I think most of us who are on this call, probably didn't experience the 1918 Spanish flu. So it is a quite an event in which the vast majority of the world economy shut down, and based on World Bank estimates the global economy suffered the largest GDP decline since at least World War Two.

So now just moving on to the first slide.

This just gives a little bit of context on the moves that we saw in our markets at a product level to reinforce the severity of what happened. As you can see, Treasury yields suffered their largest daily percent shifts ever. On the equity front, the nine largest dollar moves in the history of the S&P 500, the 10 largest in the Dow, and the seven largest in the NASDAQ occurred in March and April 2020.

And finally, crude oil saw the two largest dollar percentage price moves, ever.

But we think that's important in context as we continue to discuss the response of CCPs to the COVID pandemic and the stress that’s associated. Moving on to the next slide, please.

Despite this historic volatility, CME Clearing and obviously I’ll be focusing on CME Clearing, did not make any changes to its BAU approach to managing risk. Very importantly, one of the things that CME did not change is the fact that anytime we made an increase to margins, we gave our members and the market at least 24 hours notice before those increases became effective.

Now, what that allows participants to do is to rebalance their portfolio as they see fit in response to the margin changes and gives them the chance to take actions as necessary to address any funding requirements that they might have. Also, I just want you to know that there were no ad hoc margin cycles run by CME throughout this time. As many of you likely know, CME collects and pays out variation margin twice a day for its base offering. So it's a -- it's an exchange-traded derivatives offering. And once a day for interest rates swaps, and on the initial margin front we collect initial margin twice a day for exchange-traded derivatives and once a day for interest rate swaps.

Now, a couple of important points here, and one in particular, is that if you compare, and we'll see more of this on the next slide, the variation flows to the initial margin adjustments, you'll see that the price volatility significantly exceeded any margin changes. And I would also note that from a portfolio coverage perspective, we covered 99.97 percent in base and 99.87 percent in IRS, which significantly exceeds the regulatory expectations.

Moving to the next slide.

So what this shows is throughout the March and April time period which are the two -- which is the most volatile two months of this entire stress, the average day-over-day margin change, and the maximum day-over-day margin change as compared to margin-on-deposit. As you will see, it's approximately one percent on average, and 6.47 percent, approximately 6.5 percent, at a max level.

So while there has been some discussion about the size of margin increases over longer time frames, it’s important to note that on a day-over-day basis, the margin increases were relatively mitigated, both from a match perspective and on average.

Moving on to the next slide please.

And this is an important comparison. We've had a lot of discussions here about the level of stress and the level of price moves that were observed during the COVID pandemic. And what this compares is the max mark-to-market or variation flow in a single day to the max initial margin change with one explanatory note that we're actually showing the initial margin, at least for exchange-traded derivatives, on a net basis.

Now, the reason we do that is variation is paid and collected on a net basis whereas customer gross margin has been collected in the U.S. since, I believe, 2012 for both exchange-traded derivatives and swaps. So in order to have an apples-to-apples comparison, we are removing the impact of gross margin on the customer level for exchange-traded derivatives in this comparison. And so, what you see is that effectively, the price moves, which are reflected by variation, are almost three times as great as the maximum initial margin change.

And so, what that demonstrates is that the goal of having antiprocyclical margins that will mitigate margin increases is accomplished by the fact that almost two-thirds of the price move is not needed to be addressed in initial margin changes.

So we think this is an important slide to demonstrate the difference between the price moves and the initial margin changes at CME Clearing.

Next slide please.

Now this, I think, has taken on a bit more importance as we discuss the implications of open interest for margin changes of CCPs. I know that in the previous presentation, there was a discussion about the fact that open interest did not materially change. I think what's important to point out on this slide is in particular the E-Mini S&P. That is consistently representing the largest margin for any single product at CME Clearing. And in that case, the open interest increased by 32 percent from the end of January to the end of March.

Now this 32 percent change resulted in approximately $68 billion in initial margin for the E-Mini S&P. So while the overall increase in open interest was a little over 8 percent, so still an increase, the E-Mini which is by far the largest contract from a margin on deposit perspective, increased 32 percent, which effectively means that a significant portion of the margin increase, or at least the material portion, was driven by an increase in open interest.

You can also see that a significant increase in open interest occurred in the WTI contract as well.

So just to clarify, those contracts that represent large portions of initial margin on deposit, in particular the S&P, did have a significant increase in open interest between the end of December 2019 and the end of March 2020.

Next slide please.

So this is just the slide -- and I'll cover this relatively quickly, but I just wanted to note that we at CME Clearing do compare the antiprocyclicality of our margins to some of the global standards for antiprocyclicality. And as you can see, the 1-day and 30-day increase in initial margins at CME were lower than the increases using one of the standardized tools for antiprocyclicality and margin. So we do believe that targeted antiprocyclical measures are important in CCP risk management.

Next slide please.

So the next four slides -- and I'm going to go through them relatively quickly, are using the same unit of measure and comparing the price changes in four different products to the initial margin changes. And as you can see, there was repeated stress, significant price changes, and relative to the changes in initial margin they were significant, and very much larger than those initial margin swings, so go on to the next slide.

So you see the same thing here. Larger price moves than initial margin changes by an order of magnitude.

Next slide. Same thing here. Same theme, I will not spend too much time. Next slide please.

And again on COMEX Gold. The same theme is that the price changes dwarfed the changes in initial margin. So now moving on to the next slide please.

So, we provided this slide because there has been some discussion, you know, at a general level, about the implications of clearing on overall funding in other markets, and what actions were taken by participants in response. And so, this is demonstrating the excess margin on deposit at CME.

And as you can see, there was a drawdown of that excess margin on deposit which we would expect during such an environment, but it very quickly returned to previous levels. So while there was a short and relatively sharp drawdown, the excess margin did not take long to return to the six or seven percent average that we had seen prior to the COVID stress.

Moving on to the next slide please.

This is a very important slide, I think, from our perspective. In particular, we've seen lots of discussion about dash-for-cash, and a lot of policymakers considered the implications of the dash-for-cash on a variety of financial credit markets within the financial system.

And so, this is obviously only what we've observed at CME Clearing. But, from our perspective and the data that we have, we actually saw a significant increase in cash at CME Clearing, and to note, much more significant than any increase in margins. Margins went from approximately $145 to $150 billion to around $250 billion at the peak.

In contrast, the cash we have on deposit went from the high $20 billion range to over $90 billion. So it more than tripled. And that has maintained throughout the period.

So one of the points I think that we wanted to make here, is that at least from the data that we have, and what we have observed in our markets, there has not been a dash-for-cash and it's important to note that the clearing members could have met their obligations in U.S. Treasuries very easily if they needed cash for other purposes.

We don't have any cash minimums, I know that some CCPs do but to be very clear, we don't. So, the inclusion of this cash or the deposit of cash with CME Clearing is very much voluntary in nature and it could have been substituted for other collateral types, in particular U.S. Treasuries.

So, I think that is the last slide in the presentation. And so, with that I will give up my time. Wish everyone happy holidays and thank everyone again for the opportunity to present and cover on this important topic. Thank you.

CHAIR KARNA: Thank you very much Mr. Downey.

The third presentation will be from Dmitrij Senko, Chief Risk Officer and member of the Executive Board at Eurex Clearing. Please go ahead, Mr. Senko.

MR. SENKO: Hello, can you hear me well?

CHAIR KARNA: Yes, we can. Thank you very much.

MR. SENKO: Okay, perfect. Well, thank you very much for the possibility to contribute today, and I will present some facts and figures how Eurex Clearing went through the crisis this year but also will provide some perspective of Eurex Clearing on the industry discussion that we also have today.

So if you can move to the next slide, please. The next one. Next. So our thinking -- yeah, I think let's start with this one.

Our thinking is that 2020 was an important year where the financial architecture which was designed and has been implemented since 2009, was put into a big test, and it's worth looking into how it behaved throughout the crisis.

So again, the key logic of central clearing is if it's stripped down to a very few bullets, it's about collateralizing of exposures. And if we follow analogous logic, collateralizing exposures what could change there over time, the collateral which is required is in a way a function of what happens with portfolio, what happens on the market as markets regime changes, and what happens with the risk parameters that are used to quantify exposures.

And in all these three drivers, we observed changes, understandably, due to the happening on the market. But let's keep it in mind collateralization of exposure is essential in the logic of a clearinghouse.

Let's go to the next slide, please. This next one.

So that's the chart on the intraday margin calls that were performed in the months during the crisis and some months before and some months after. The number of margin calls was higher, much higher than usual and the amounts that were collected were much higher. And this is related to the situation with market moves were pretty large back in the day, as we have seen now in a few presentations on that one.

And currently, as we see it continuously see that intraday margin calls are back to normal levels. That's one piece on how Eurex Clearing performed during the crisis. Now, next slide. And, yeah, the next one. Please.

More facts and figures. That's the view on the total margins, that over time that Eurex Clearing collected. And here we see before the crisis we've been at the levels of around 60 billion and into the crisis, the margin, the total margins collected peaked at around 110 billion, so almost doubled. And since then, it is gradually declining, and consistent with the observation that volatility regime is getting back to normal, not completely back to pre-crisis levels. We have seen, for example, a small spike after the U.S. presidential elections due to vaccine announcements that is visible here, so volatility picked it up again. But overall, we are now at around 70 billion margins.

If you look at the table below, you will see the breakdown into cash, non-cash and a few metrics there. So, when talking about the -- it's important point when we later talk about intraday margin calls mechanics, we also accept non-cash and it's a pretty material portion and remained pretty stable throughout the crisis at around, almost 50-50 of cash and non-cash.

If you can move to the next slide please.

That's now a deep dive into a product level back-test. We have seen similar charts before, so earlier today that's our benchmark product Eurostoxx 50, index product and the chart outline, we see here margin levels, both for long and short-term -- long and short contracts, margins with and without floors, and the blue dots are the profit loss.

Here, taking a three-day view, because our holding period -- margin period of risk assumption is three-days for this type of contract. Here we see at the beginning of the crisis model we started into the crisis at the levels of around seven percent, if I take the long contracts and gradually it increased now first to 17th and to 20, and now it's gradually decreasing with some increase again after the vaccine related news in November.

So, most of the back-testing breaches were happening at the beginning of the crisis where the margins were too low. And so, one is to observe how big is the breach and another one, it's interesting and if you go here, the margin reacts a few days afterwards, by increasing the levels of margins to adapt to the new level of volatility.

This adaptation is done automatically in our model. So, our model is a formula, which has -- takes as inputs the level of volatility. And basically, starting from there it's there is no manual interactions, interventions. We haven't adapted any formula or any parameter within the formula throughout the crisis. So all, what's happened -- happens based on the predefined formula which was tested before the crisis when we introduced the model, like a few years ago.

The parameters are regularly recalibrated usually, but throughout this period we didn't have to adapt. So, now, pausing here and talking about transparency and predictability.

There are few layers of predictability. One is when the model is completely transparent, the formula is there. Understandably, we don't know what the market move will be, but if someone knows what is the market move he can use the formula and calculate by himself, what would be the response of the margin.

So that's kind of the way we are approaching the margin models, and that's to be seen in contrast, maybe other margin models where the formula is not known, and the margin is adapted based on some less transparent criteria.

Another point of note here: floor and without floors, if look at the beginning of the chart these dotted lines are the -- what margin would have been without floors. So without floors, we would have started into the crisis at the level of four to five percent margins. With floors, we started into seven, with seven percent level, roughly. And yeah, that shows how the floor helps to -- the margin not to jump and not to triple or quadruple, that maybe to produce a change of only 2.5 if it’s looked at this kind of scale of several months.

Okay, let's move to the next slide please. And next one.

So, some reflection to the industry discussion. Now there are two views possible on what happened and they are interchangeably mentioned, or a mixture of those as mentioned in the papers that are being discussed. One is to say, it seems that the CCPs and clearing industry worked as designed, as it was designed in 2009. Another way is to see, to view it in a way with this important data set and in general it's common sense to look at how things are being done, understand the current state and potential limitations of the current state.

And to think what could be improved, a common sense of continuous improvement thinking and more so given that we have such an interesting year behind us or still within this year and that's our approach, and we are happy to participate in this discussion and also in the industry discussions going forward.

Next slide, please.

So, our take on the discussion landscape is outlined here and I will go through a few topics. If we start with the bottom part, we are on the margin model. All the topics about margin models we are pretty much aligned with the FIA paper here on the floor. So we have stress period floors in place that go further than 10 years back so we still have the 2008 crisis in there.

We have this formula-based approach which is in terms of predictability is transparent.

Now on reactiveness, if I talk in the discussion points that are possible or needed. It's actually the industry discussion should be there and the agreement should be sought how quick, or how slow margins should react in a way in a typical model, it’s one factor, index decay factor or half-life parameter which is usually used and there should be a consensus of how quickly it should react and starting from there it could be adapted.

It has to be named. Now again continuing with the trade offs here. That least procyclical model would be a flat margin, which is in itself is a bad model as well or a bad properties as well. It usually -- if the margin doesn't react to changes in market volatility, usually there are a lot of margin breaches or the margin it should be set very high, also throughout periods of very calm markets.

So I think consensus and current thinking and in the modeling of the margins or any risk number is that there should be some level of reactivity to the increased volatility on the market.

If we go to margin period of risk, we are again here pretty much aligned. Our margin period of risk setting is educated by our default management process. So, we have fixed-income derivatives with two-day periods, trade frequency derivatives with three-day periods, and for OTC five-day. And then the thinking is to have margin period of risk set to be enough to be able to liquidate the portfolios.

In terms of trade-offs, I think this has to be looked at whether one-day is sufficient or whether, and I think we are here in line with FIA paper that the thinking of alignment between margin period of risk and default management is -- yeah, is the principle which will be applied.

On back-testing, we have product and portfolio level vectors. Here one learning or one trade-off that we noted in the industry discussion, it makes sense to compare apples and apples and back-test their margins of different CCPs against the same one-day PnL, because PnL is reality and margins are models so compare different models with the same reality, we should take away the same reality. It doesn't make sense to back-test some CCPs against three-day PnLs with a one-day PnL.

Then yeah, the outcomes are biased if we do that, so proposal is to have aligned back-testing PnL. And on concentration and liquidity, we have them built into the model and the question is, again, on the modalities, should it be really within the initial margin model, which is updated intraday or there could be solutions where concentration add-ons are outside and then updated only once per day or less frequently.

So there are design choices -- different design choices possible.

So for IM initial margin model we're pretty much aligned. Let me quickly run through the intraday margin call which poses a broader set of topics to discuss.

So, here, it is important to differentiate into different drivers for intraday margin calls. Three main drivers are market moves or position change or margin features. We have seen also from few presentations today it's most -- well, yeah, two hypotheses and the position changes. Everyone who argued here, that it’s not so big but market moves is big and margin features is was argued it’s big, but I think it's not in our case. We haven't changed margins intraday, it's happening overnight, and gradually with this formula.

Market moves, yeah, we think are the biggest ones.

Now in terms of timing of the margin calls. It's -- there are two different possibilities. We have event-driven margin calls, meaning that we have a risk model in place which quantifies changes of exposures on a near real-time basis. So if there is any market move or any position change, the margin is calculated within several seconds, and then if shortfall, if collateralization situation is such that model requirement is higher than collateral, then it is an event for -- the case to issue the intraday margin call.

There are operational thresholds in place, but still it's event driven and the biggest design choices here are batch driven, scheduled margin calls or event driven margin calls. Here the clear trade-off is operational facilitation of clear times and clear batches versus yeah, if the market move is happening between the batches then there is uncovered exposure to

CCP, which remains uncovered until the next batch.

In terms of covering by non-cash, we allow the intraday margin calls to be covered by non-cash, so even if it’s driven by the change in price, which on the other side prevents us from paying out cash to say, the losers and gainers from the market move, from those who are losing money we can accept intraday non-cash but this means we cannot pay out cash to better than those who are gaining.

So, there is a symmetry, driven by the situation that we allow non-cash intraday, and the -- another design choice would be to really introduce pay-in/pay-out during the day, which has to be evaluated -- discussed. It has its own downsides with the operational burden of paying in and paying out, several times of day in all the currencies that are now being cleared in all the product currencies consistently.

And (inaudible) level way and in terms of predictability, I think one type in terms of solution space, there is a timing predictability and amount predictability remains unknown because the amount is usually, we saw the biggest driver is market change and markets no one can predict.

So, but as a small improvement of the operational and transparency on the way reports are possible, we have the reports -- every 10 minutes we produce the reports that outline what is the collateralization situation, what is the margin, what is collateral. So based on this report, it could be an early signal, or previous to an early warning and early planning for what could happen soon if the market movements are linked. So, yeah, I think that was good.

Let's move to the next slide.

And on margin model, again I think there is a zone of potential agreement. Also from what I heard today, I think, everyone had a slide on back-testing and how margins performed here is our proposal, but to progress in any direction of discussion, a first step would be a fact-based analysis of the data set for 2020 where, you know, all the CCPs have the product level margins and behavior. And this can be held and understood what are the back-testing metrics on top of it; and then same data set informs also procyclicality metrics.

So two metrics also even give insight into liquidity matters. For example, if we take this maximum rate of change or condition model of a one-day. This gives us a number of 16 percent, 24 percent, similar numbers that we have seen on other slides today. So rate of change from one day to another, initial margin can change like 16 percent.

Now if you look at another metric here in green box, it's loss to margin ratio, that one day loss -- worst loss divided by margin on the previous day. This goes as high as 103 for Eurostoxx, my second example. This means that if you have initial margin of x. You could have an intraday margin call of 1.03 times x. It could be the size of -- yeah, (inaudible) margin call, as high as IM. Whereas, the increase of IM next day is only like 16 percent, also here we see that the biggest -- the biggest thing for intraday margin calls are the current market moves.

Okay, let's move to the next slide please. And to the next one, I think we can skip it -- I covered it.

So in terms of the discussion going forward, if we look at this, different levels, where we are discussing it -- we’ve been to the level of -- I'm presenting the perspective of Eurex Clearing, which is the box to the left bottom, 1 CCP and many CMs. And we know how it works out during the crisis, there is also one CM connected to many CCPs and serving many clients, but I think there are also higher levels of clearing ecosystems with many CCPs and many clients, many clearing members and there is also higher level of cleared and uncleared view.

So, and we evaluated a few pain points or pain points are visible from the discussions until now. I think we need to -- knowing this also pressing towards solution alternatives and intended target states, states based on what we learned and based on the outcomes, discussions, but also we should, I mean in search of systemic level solutions or to solve systemic problems that may be there, that potentially could occur, we should be looking also into solutions on higher levels.

And then, what is visible, only improvement at one CCP will probably not help progress with solutions for the overall picture.

Next slide please.

CHAIR KARNA: Mr. Senko, just let you know we're running a little short on time, so I just wanted to give you that heads up.

MR. SENKO: Yep. No, and that's the last slide so I think our view is that in short-term there is -- seems to be a zone of agreement to have this back-testing in the data-based analysis of what should be the best trajectory of margins and then starting from there the CCPs can try to approach this ideal target state so that's purely this data-driven exercise, based on margins -- product level margins and PnL, and in midterm, I think we're happy to contribute to the discussion, if we want to find further, stronger solutions to kind of higher level problems at the systemic level.

Thank you very much for the possibility to contribute today and back to you, please.

CHAIR KARNA: Thank you very much, Mr. Senko. Our final presentation will be from Sayee Srinivasan, Deputy Director in the Risk Surveillance Branch of the CFTC’s Division of Clearing and Risk. Mr. Srinivasan, please go ahead.

MR. SRINIVASAN: Thank you. Can you hear me?

CHAIR KARNA: Yes we can. Thank you.

MR. SRINIVASAN: Okay, thanks. So good morning from Washington, D.C. and at the outset, I would like to thank Commissioner Stump and the GMAC for inviting us to present at today's meeting.

Next slide please. So the usual disclaimer applies. And more specifically, I want to add a few more sort of clarifications.

As you see from the presentations by the previous presenters, there was a diversity of views on some very interesting aspects of how the systems work. So the material I'm going to be presenting today will touch on all those themes, but I’d just like to clarify that we have received, specifically the staff are still going through the analysis and we really haven't arrived at any conclusions.

So you know, we might be asking some provoking questions, but it's still just to get us engaged and I didn't find the correct issues, so I just thought to make that explicit.

Second, you know, I’d like to. I'm still on the previous slide.

Second, just in terms of looking back at 2020, we’d like to thank our colleagues in the newly named Market Participants Division. We work very closely with them. And we did that through March and April and sort of continued to work with them, but we’d also like to thank the DCOs and the FCMs and other market participants.

We keep bugging them for lots of information, and we really appreciate the support and collaboration.

And finally, from a regulatory perspective, while CFTC has been spending a fair amount of time studying and analyzing and understanding what happened in the market and helping function, we’ve also been spending a lot of time with other regulators, both in the U.S. and internationally. I know daily, weekly, and sort of regular calls multiple times a day and that's been a pretty important part of what we've been doing this year.

Next slide.

So, because some of the themes I’m going to be covering are essentially the same ones that the other presenters had done, so I won't spend much time on this.

Next slide.

It's also shameless marketing for the Risk Surveillance Branch. It might be one of the well-kept secrets at the CFTC. So functionally, we are responsible for three things: one is margin model oversight, a lot of discussions of margin model performance so that's -- we have a group that's dedicated to studying margin models, doing quantitative assessment for margin models.

So the stuff is pretty close to what we do on a daily basis.

The Commission is -- we receive very rich set of highly granular reports daily from the DCOs and FCMs. And over the years we've invested a fair amount of effort to develop this quantitative data surveillance program where we can do pretty granular analysis of the product level account or portfolio level and sort of firm-entity level both for for F&O and for swaps.

And then finally, we do care about the CCP resilience and systemic risk issue, but from very quantitative perspective, and you see that through our supervisory stress tests. Next slide.

So this is a picture that other -- a similar representation that others have shown. And this basically shows that the initial margin which was posted with the CCPs during 2020. The dark line, the blue line basically shows the -- sort of the rate at which the IM collected was changing and you can see there was a nice spike that occurred in March, and sort of slowly trending downwards as volatility subsided a little bit.

Next slide.

So once again, a similar chart like as others have shown. We had the pandemic and there was a huge increase in both IM and VM. And just one thing I'd like to point out is there could be days when the CCPs would have returned some IM to the market participants. What we capture here just the sort of the positives flows.

Next slide.

Once again, others have pointed this out. You know market models are not supposed to cover all the moves, and some of the shocks that we saw in March and April, they were clearly you know beyond the 99.7 or 99.8 coverage that many CCPs target. So, we had sort of the job we do on a day-to-day basis -- you know, we keep reminding ourselves that IM is meant to help CCPs cover the cost of liquidating a defaulting member's portfolio. In that sense, it has a very precise functional purpose.

And so, the more important question that others have been discussing, and for us, is that how well did these markets -- the models function and whether the models reacted appropriately.

Next slide.

Nick and others have spoken about this. So we do track product level features, we find them interesting and apologies for the very busy slide. The picture on the top just is our way of tracking product level breaches and you're able to size it by the size of the IM, so that we're focusing on the more important contracts. The one, the picture -- the bottom picture just is our attempt at trying to put a dollar value on the size of the beaches.

And what we see is as we go about doing our business and you know tracking all this activity and performance at account level and so on and so forth, we are acutely aware of the fact that products will not default, and we find the discussion of product level breaches very interesting as I said, but we are also very conscious of the fact that a product does not default. Firms are the ones who have the potential of defaulting.

So that raises the question as to what sort of account level breaches we have seen. The CPMI -- the quantitative disclosures by the CCPs contain some information in the public domain. But what we see from the regulatory data is that yes, there were account level breaches. But they were pretty small in number. That's the first point.

Second, is as we sort of dig deeper into the constitution of the portfolios of those accounts. They tend to be smaller accounts and pretty -- with less diversified, more directional holdings. And we're able to sort of aggregate the positions across, the liabilities across all these accounts and make an assessment of, you know, whether there was anything adverse to the clearing member or the CCP, and we felt comfortable that we never got to the point where there was any concern.

So, but, you know, we keep reminding ourselves of that, you know, while products are important, what really matters is what's happening at the account level.

I'll sort of segue to -- next slide -- to a couple of sort of macro-ish type questions and similar to what others have been talking about here, I want to provide some illustration of where we are and some other analysis and then some initial findings.

So the first question I'm just going to touch on two questions. And the first question is, were CCPs' margin models too reactive to the shock? And hence, not appropriately antiprocyclical.

Next slide.

So, this is what we have here is, this is for interest rate swaps across the three DCOs who covered these instruments, and we are tracking activity at client level, not house, just client level. We have three, and this shows activity from February of 2020 until a few weeks ago.

The blue line shows daily aggregate IM for these accounts, and it's indexed to hundreds, so basically, such as 100 for the values throughout 2020. The red line shows daily aggregated gross notional size of these accounts. I know there was a discussion of what is happening in the context of open interest and they were trying to do a similar tracking about what is happening to position changes.

And this is also an indexed number. The green line is a sort of a standard measure of risk and interest rate swap markets, it sort of measures the DV01 of these portfolios. In other words, the dollar value of one basis point change in interest rates.

So we know that changes in IM that's collected by the CCPs are driven by broadly two factors: One, position changes, record activity that's happening in the markets and there's some interesting discussion by the previous panelists on what is happening in different markets. And the red line attempts to sort of capture the sort of position change factor.

And the second is CCPs' models' reactions to volatility.

Now if you look at the aggregate numbers, one could read certain patterns in the data. So, fortunately, we have access to more granular data and so we will be looking very carefully at disaggregated data. But, you know, we have seen some discussions in the public domain of people sort of trying to draw conclusions by just looking at aggregate data, so we have sort of been digging deeper.

And you can go to the next slide please.

So what we have done here is -- this is for interest rate swaps again. And we have sort of disaggregated the -- those three time series of variables across, in different categories of market participants. We have asset managers, insurance companies, hedge funds and banks.

And when I say bank, it's a bank that will come in as clients of clearing members or FCMs.

So as we dig deeper into data, what we observe is that there's a fair amount of heterogeneity in IM flows. We do see IM increasing across all these different types of market participants, but the position changes are very different across these participants. And also, you know, the risk behavior within each group of these firms is very different.

So clearly in a portfolio, competition matters. Next slide. We do the same thing for CDS and we're in the process of doing something similar for F&O also.

Here instead of gross notional, we are tracking net notional. That’s the only difference, and then instead of DV01, we're tracking the dollar value of a basis point change in the credit spread. So, as you can see, based on the data we have, there was some interesting drop in activity in sort of open interest if you measure it as sort of the net notional.

Next slide.

As you disaggregate it, once again we see a fair amount of heterogeneity among the different groups of market participants. In some sense, it is more drastic than what we see for interest rate swaps. And as we all know, there was a fair amount of volatility in the credit markets. In some sense, we could argue that they were more volatile than what we saw in the interest rate market also.

So, we continue to do further analysis, but I just wanted to give folks a flavor for, and as we get deeper and deeper into the data, some of the patterns one might see in some of the conclusions you might find by just looking at aggregate data, they start breaking down. So there is more analysis to be done, and we anticipate we will be busy conducting that analysis through 2021.

Next slide, please.

This is my final slide and the second sort of macro-ish question that we have been interested in, is and others have spoken about it, which is did margin calls cause stress in the funding markets and stress among market participants?

What we are engaged in right now is trying to get -- conduct empirical database analysis to collect evidence of what actually was happening. We are really interested in understanding the impact on the broader system, on clients, on members because, in some sense, you can say that, you know, the whole idea of APC is to sort of balance the interests of CCP resilience with broader market functioning.

And one challenge we are facing, that we keep running into is what we call the denominator problem. As you've seen, we have incredible access to IM and VM flow data at the granular level for the cleared markets. The biggest challenge is getting access to data to assess the relative size of these flows, relative to the other liquidity demands that clients were facing, intermediaries and the broader financial system.

So we are engaged in working with market participants to collect more data and conduct the analysis so that we can sort of look at these things more holistically.

Once again, this is going to keep us busy through 2021. And we look forward to coming back to the GMAC and its members and providing you all an update. Thank you.

CHAIR KARNA: Thank you very much Mr. Srinivasan. Commissioner Berkovitz, do you have a question for our panel?

COMMISSIONER BERKOVITZ: Yes, thank you.

Thank you to all the panelists for very interesting presentations and perspectives, and one fact in the presentation that really struck me was in the CME presentation, talking about the relative percentage change in open interest and where the significant change in open interest, most significant, were on the E-Mini S&P and WTI. A 32 percent change in E-Mini S&P and an almost 30 percent change in WTI, and the initial margin requirements that CME is presenting on that page show that equities in E-Mini S&P have the most significant or the largest initial margin requirements.

I'm aware, anecdotally, that one thing that happened and I think this is, we saw this in WTI, but anecdotally, what I've been hearing is around this time, there was a significant increase in retail participants and people sitting at home at their computer, people thinking the market’s crashing. A lot of retail people jumping in the market. We had a number of brokerages unable to handle the retail volume.

So I guess the question would be, to what extent are these -- a lot of the increase in open interest and then the resulting increased margin requirements due to new market entrance due to retail participants? And I guess the answer to that may affect the balance between, if we find there’s more margin increases during this period and maybe to avoid these -- to address the procyclicality, people are talking about floors, but if a lot of these new margin requirements are caused by new market participants and retail people coming in in a period of incredible volatility, then you're basically -- one consequence you’d basically be saying “Well, everybody's got to pay up before,” so that when new people come in, in a time of volatility, you know, not everybody doesn't have the stress of the procyclicality.

So I think the composition of the market is also something that is interesting -- would be interesting to look at, and I was wondering if any of the panelists or any presenters have any perspective on that. Are we seeing or did we see a difference in composition of the market that new people coming in, and therefore that was affecting the margin requirements, too?

MR. CUTINHO: I can take that. This is Sunil from CME. Can you guys hear me?

CHAIR KARNA: Yes, please go ahead, Mr. Cutinho.

MR. CUTINHO: Hi. Commissioner Berkovitz, I am afraid I can't tell you exactly the composition of the clients. There is one difference to keep in mind that we now have gross margining, we did not have that during the global financial crisis.

So, as you pointed out, if -- you know the two things can change. You know if you're looking at aggregate margins, you know, as the level of participation from existing participants if they are adding on to the open interest and the open interest captures that at a higher level. And then also addition of participants, new participants entering the market.

So from CME’s perspective, we rely on our firms to actually enumerate the positions of each of the clients and we margin each of them individually, and then we take the gross of that amount and call on member firms.

So, it's hard to answer that question without actually looking back and identifying the participants across that time period.

MR. RUSTAD: Maybe I can have an interesting perspective. Please, Commissioner Berkowitz, it's Nick Rustad again.

I tend to agree with Sunil, I don't think the underlying participants in the market and whether they are in or out, or new people coming in or out, should affect the level of initial margin, which a CCP set for that particular margin. One of the reasons why we would ask that initial margin would be set appropriately and cover a range of scenarios is taking into account new entrants and a variety of market participants.

I think one slightly more interesting subtopic from the topic you raised about retail participation is -- how is the retail participation happening, which member firms are they accessing the market through and what is the capital standards of those particular firms?

Because I think the issues which we touch upon is we’re obviously worried about systemic risk in the system. And I think we've heard a couple of times today and previously, and I referred to it in my remarks, the bringer of risks to a system should backstop for risk in the system.

But when these new participants are coming and they're coming through, you know, potentially weaker capitalized entities, then I think that's, you know that is a cause of concern.

CHAIR KARNA: Thank you Mr. Rustad. I recognize that we're running short of time. Ms. Hong, would you like to offer some final comments.

MS. HONG: Yes, thank you. Hi, it's Amy Hong from Goldman.

First, I'd like to thank the panelists for your thoughtful and thorough presentations. The industry has so much more to learn from how the markets performed under pronounced stress in March, including the impact of post-crisis reform. We have the benefit of a significant amount of data as evidenced by the presentations today, which will guide a thoughtful and thorough look at what worked well, what didn't. And what may need to be recalibrated.

As it relates to margin levels, there is a tremendous amount of work and thought leadership already in the public domain from clearing members to CCPs, the buy side and regulated. And, you know, I very much appreciate the efforts of the CFTC, including Commissioner Stump with the GMAC and Commissioner Behnam with the MRAC, to bring us together on one of the most challenging and important issues for the stability of the derivatives market.

We look forward very much to continuing to collaborate with our clients, peers, and the CCPs, and the CFTC to build upon the current framework. Very much, you know, in particular I commend the FIA for their leadership and helping to drive an informed, data-driven discussion. There are clearly more reflections to be had, not only about increasing margin levels, but also about appropriately calibrating inputs, like the margin to rate of risk on certain products, margin levels in times of low volatility, and whether floors should be instituted with appropriate and transparent look back periods to ensure the resilience of the clearing ecosystem in both good times and in bad.

So, you know, with that I’d just like to reiterate, you know, very much my appreciation for the opportunity to engage in this dialogue with all different perspectives around the clearing ecosystem. Thank you very much.

CHAIR KARNA: Thank you very much Ms. Hong.

Mr. Cutinho, I think you have a couple of comments that respond to the presentations and then I'll turn it back over to Andree.

MR. CUTINHO: Thank you. I'd like to thank the presenters as well for a very informative presentation across the board. But I'd like to draw three things to the panel's attention.

First, you know, we try and look at margins as a percentage of notional in the contract but there are serious problems with that approach. So, I'll give you a very simple example. If you kept margin rates constant and if the market dropped by 30 percent, margin as a percentage of notional would increase by 43 percent.

So, it is not a good comparison. And you wouldn't want margins as a percentage of notional to remain constant and fall, especially when risks are increasing.

The second -- you know, I don't think, you know, I think we need to actually be careful comparing the global financial crisis to the pandemic. I'm heartened by the fact that many people recognize that, but a few things to note.

One is volatility. If you look at 20-day volatility, increased 500 percent during the pandemic. It was not the case during the global financial crisis. So when comparing margin increases, and I think the presenters tried to do this, it's important to compare the margin increases to the environment we are in. Notwithstanding the, you know, the -- notwithstanding the side effect of greater costs for market participants to keep their risk exposures or take on more exposures.

The second thing about comparisons. You know, it's not the same environment. During the global financial crisis, we did not have gross margining. We have gross margining now. So the numbers are a little bit inflated.

And then with respect to retail participants. I think it's wrong to conclude that retail participants in and of themselves are risky. It's also wrong to conclude that because we have more retail participation, they would come in through weakly capitalized firms. I think, you know, and this is true with CME, we always look at clients, and we look at firms. We look at firms, and the clients that they support, we look at the capital that they have. Capital wherewithal that they have, and we compare that to their clients. Not only on the rate of the exposure relative to the firm's capital. But we also compare their stress losses to the firm's capital.

So I think there is no substitute for managing risk but I would urge people not to walk away with prejudices against either firms who are small or clients who are retail, rather than institutional.

And then finally, I would say that I know there is a temptation, and I've seen this happen to constrain CCPs, or any counterparty, from covering their risk exposures. We completely understand the concept of antiprocyclicality and I believe we've demonstrated that.

The important thing is to resist the temptation to place constraints, because not all crises are the same, and CCPs as well as clearing firms, as well as nonclearing counterparties, need tools available to them to manage risk. If not, we are going to introduce more systemic risk. So with that, I yield my time.

Thank you.

CHAIR KARNA: Thank you Mr. Cutinho. I would note that we're a couple of minutes over time.

Commissioner Stump, this has clearly been a very robust forum and we still have some additional comments but I'm going to turn it over to Andree to finish out today's agenda.

MS. GOLDSMITH: Thanks Angie. I'll just quickly turn it over to the Commissioners for any closing remarks. I'll start with Commissioner Quintenz.

COMMISSIONER QUINTENZ: Thank you, Andree. I don't have any closing remarks, other than to say that I thought this was one of the, if not, the most informative and data-driven and insightful advisory committee meetings, of which I've ever been a part and appreciate some of the different views around that data, some of the hard questions that are being asked.

But I found it wonderfully productive and informative and appreciate all the hard work that was put into these presentations. Thank you very much.

MS. GOLDSMITH: Thank you. Commissioner Behnam.

COMMISSIONER BEHNAM: Thanks Andree, I'll echo Commissioner Quintenz's statements. A really excellent discussion and thanks to you, Andree, and Angie, and Commissioner Stump, and of course, all the panelists from stakeholders from the private sector and of course, the CFTC staff who were able to present. A lot of great takeaways and look forward to continuing the discussion. Thanks.

MS. GOLDSMITH: Thank you. Commissioner Berkovitz.

COMMISSIONER BERKOVITZ: Thank you. Yes, I would agree with both Commissioner Behnam and Commissioner Quintenz, excellent presentations. Very data -- very data-driven but that's what we need to make sound regulatory decisions, the best information available.

So, thank you for the presentations and not only data-driven but diverse viewpoints, and I think we're strengthened by having a variety of viewpoints and perspectives on the significance of that data.

So, thank you everybody, for all the presentations, and again, Andree and Angie, and Commissioner Stump for your leadership in setting up this presentation and meeting today. Thank you.

MS. GOLDSMITH: Thank you. Commissioner Stump.

COMMISSIONER STUMP: Thank you, Andree and thanks Angie for managing today's meeting.

Several months ago when we were discussing potential dates to hold this meeting, I had truly hoped that by scheduling today's meeting towards the end of the year that we might be in a position to convene in-person. And while that's unfortunately not the case, I'm very thankful that we can continue to advance the GMAC’s priorities in a format that ensures everyone's health and safety.

I'm also very grateful to the GMAC members for continuing to engage with the committee this year, despite the challenging circumstances, and I think, as indicated by the fact that we've run out of time today, we have so much more to discuss in 2021 and I very much look forward to that. I'm hopeful that I will see all of you again in-person in 2021.

And as this is the last public meeting of the year, not only for the CFTC's five advisory committees, but also for our Commission, I wanted to commend all of my regulatory colleagues around the world as well as the market participants and infrastructure providers who have contributed to preserving sound and efficient markets during this very challenging year. I wish everyone happy holidays and may your New Year be safe and healthy.

Thank you.

MS. GOLDSMITH: Thanks Commissioner Stump. I also want to thank everyone for attending today's GMAC meeting and I wish everyone a safe and healthy holiday season. This meeting is now adjourned. Thank you.

(Whereupon, at 12:08 p.m. EST, the meeting of the Global Markets Advisory Committee was adjourned.)