MINUTES OF THE DECEMBER 11, 2023 MEETING OF THE U.S. COMMODITY FUTURES TRADING COMMISSION'S MARKET RISK ADVISORY COMMITTEE

The Market Risk Advisory Committee ("MRAC") convened for a public meeting on Monday, December 11, 2023, at 9:38 a.m., at the U.S. Commodity Futures Trading Commission's ("CFTC" or "Commission") Headquarters Conference Center, located at Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. The meeting consisted of five sections. Section 1 was a roundtable providing a broad market overview of Central Counterparty ("CCP") risk and governance from an international perspective. Section 2 comprised CCP Risk and Governance Subcommittee updates and reports. Section 3 comprised Market Structure Subcommittee updates and reports. Section 4 discussed workstreams operating in the Climate-Related Market Risk Subcommittee. Section 5 discussed workstreams operating in the Future of Finance Subcommittee.

<u>MRAC Members in Attendance</u>

Robert Allen, President and Global Head of Fenics Rates, FMX Futures Exchange, L.P.
James Andrus, Vice President of Sustainability Global Markets, Global Sustainability Strategy Team, Franklin Templeton
Ann Battle, Senior Counsel, Market Transitions & Head of Benchmark Reform, International Swaps and Derivatives Association, Inc.
Stephen Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel LLC
Richard Berner, Clinical Professor of Management Practice in the Department of Finance and Co-Director, Stern Volatility and Risk Institute
Biswarup Chatterjee, Biswarup Chatterjee, Managing Director and Head of Partnerships & Innovation for the Services Division, Citigroup
Alessandro Cocco, Vice President and Head of Financial Markets Group, Federal Reserve Bank of Chicago, on detail at the U.S. Department of the Treasury
Alicia Crighton, Chair of the MRAC and Chair of the Board of Directors, Futures Industry Association ("FIA")
Neil Constable, Head of Quantitative Research and Investments, Fidelity
Edward Dasso, Senior Vice President-Market Regulation, National Futures Association
Gina-Gail Fletcher, Professor of Law, Duke University School of Law
Graham Harper, Head of Policy and Market Structure at DRW, FIA Principal Traders Group
Lindsay Hopkins, Chief Corporate Counsel, MGEX Clearing, Minneapolis Grain Exchange, LLC
Annette Hunter, Senior Vice President and Director of Business Operations, Federal Home Loan Bank of Atlanta
Demetri Karousos, President and Chief Operating Officer, Nodal Exchange, LLC
Eileen Kiely, Managing Director, BlackRock
Derek Kleinbauer, President, Bloomberg SEF LLC
Ernie Kohnke, General Counsel Vitol, Commodity Markets Council
Jonathan Levin, Co-Founder and Chief Strategy Officer, Chainalysis, Inc.
Chip Lowry, Board Member, Foreign Exchange Professionals Association
Purvi Maniar, Deputy General Counsel, FalconX Bravo Inc.

Craig Messinger, Vice Chairman, Virtu Financial, Inc.
Andrew Nash, Managing Director and Head of Regulatory Affairs, Morgan Stanley
Ashwini Panse, Head of Risk Oversight for ICE Clear Netherlands, and Chief Risk Officer for the North American Clearinghouses, Intercontinental Exchange, Inc.
Jessica Renier, Managing Director, Digital Finance, Institute of International Finance
Marnie Rosenberg, Managing Director, Global Head of Central Counterparty Credit Risk and Strategy, JPMorgan Chase & Co.
Tyson Slocum, Director, Public Citizen Energy Program, Public Citizen
Suzanne Sprague, Managing Director and Global Head of Clearing and Post-Trade Services, CME Group Inc.
Kevin Werbach, Liem Sioe Liong/First Pacific Company Professor, Professor of Legal Studies and Business Ethics, and Department Chair, Wharton School, University of Pennsylvania

CFTC Commissioners and Staff in Attendance
Kristin N. Johnson, MRAC Sponsor and Commissioner
Summer Mersinger, Commissioner
Tamika Bent, Chief Counsel to Commissioner Kristen N. Johnson and MRAC Designated Federal Officer ("DFO")
Peter Janowski, Trial Attorney, Division of Enforcement, MRAC Alternate Designated Federal Officer
Richard Haynes, Deputy Director, Division of Clearing and Risk
Scott Lee, Senior Counsel and Policy Advisor, Commissioner Christy Goldsmith Romero
Chris Luca, Chief of Staff and Counsel, Commissioner Summer Mersinger
Julie Mohr, Deputy Director, Examinations Branch, Division of Clearing and Risk
Parisa Nouri, Supervisory Attorney Advisor, Division of Clearing and Risk
Daniel O'Connell, Special Counsel, Division of Clearing and Risk
Robert Wasserman, Chief Counsel, Division of Clearing and Risk

Invited Speakers in Attendance
Ruth Arnould, Managing Director and Associate General Counsel, Bank of America
Lee Betsill, Managing Director and Chief Risk Officer, CME Group
Juan Blackwell, Head of Credit & Counterparty Risk Management, Ontario Teachers' Pension Plan
Don Byron, SVP, Head of Global Industry Operations & Execution, FIA
Joesph Garelick, Member, Risk & Quantitative Analysis Group, BlackRock
Jennifer Han, Chief Counsel and Head of Global Regulatory Affairs, Managed Funds Association
Christopher M. Hayward, Policy Chair, City of London Corporation
Klaus Loeber, Chair of the CCP Supervisory Committee, European Securities and Markets Authority ("ESMA")
Jai Massari, Co-Founder and Chief Legal Officer, Lightspark
Kerstin Mathias, Director of Policy and Innovation, City of London Corporation
Rajalakshmi Ramanath, Executive Director, JP Morgan Chase Bank
Guy Rowcliffe, Co-CEO and Chief Commercial Officer, OSTTRA
Sam Schulhofer-Wohl, Senior Vice President and Senior Adviser to the President, Federal Reserve Bank of Dallas

Dmitrij Senko, Chief Risk Officer, Eurex Clearing AG
Costas Stephanou, Financial Stability Board, Head of Financial Stability Analysis
Viktor Vadasz, Executive Director, Resource Optimization, Morgan Stanley
Nathaniel Wuerffel, Head of Market Structure, BNY Mellon

I. Opening Remarks

Mr. Janowski called the meeting to order at 9:38 a.m. and introduced the Commissioners in attendance.

Commissioner Johnson delivered opening remarks. She stated that the Commission would be considering a proposed rule that addresses issues raised by the ION ransomware attack considered at the MRAC's March 2023 meeting. Commissioner Johnson outlined the agenda and previewed issues that the Climate-Related Market Risk and Future of Finance Subcommittees will begin to explore in 2024.

Commissioner Mersinger followed with brief opening remarks. She highlighted issues that would be discussed including block trade implementations, Treasury market reform, CCP risk and governance, and FCM capacity

Mr. Janowski conducted a roll call of members participating virtually and introduced the Chair of MRAC, Ms. Crighton. Chair Crighton then introduced the first panel.

II. Section 1: CCP Risk and Governance, International Perspective

Chair Crighton identified the first workstream of the CCP and Risk Governance Subcommittee: a macroeconomic view of issues that are in the spotlight for U.S. regulators and their counterparts in a number of jurisdictions, as well as multinational market participants in the clearing markets.

Mr. Hayward announced the establishment of the City of London Corporation's first ever U.S. presence. He stated that one of their core objectives is to ensure U.S.-U.K. alignment in major forward-looking areas of regulation, including crypto assets. He described planned activities enabled by the U.K Financial Services and Markets Act.

Mr. Loeber explained the background and activities of the CCP Supervisory Committee within ESMA. He provided an overview of ESMA's activities regarding identified priorities with respect to risk across the CCP sector: operational risk, procyclicality and market risk. After review, ESMA recalibrated risk related to governance and controls and recovery plans, added investment risk in comparison to risks from financial innovation and identified inherent risks for which no additional supervisory work is envisaged. Regarding operational risk, the European Union ("EU") adopted the Digital Operational Resilience Act. EU-wide CCP stress testing included for the first time operational risk elements, focusing on the increasing reliance of CCPs on shared third-party providers. Mr. Loeber discussed observations of procyclicality in stress events as a result of higher margin calls, and described planned activities regarding the mitigation of liquidity risk, peer review of governance and controls, adaptation of CCP risk models linked to concentration risks and convergence issues.

Mr. Haynes described the work of the Risk Surveillance Branch of the Division of Clearing and Risk of the CFTC. He explained how recent stress events have led to a much clearer understanding of how CCPs and participants react to an increased need for – and often an increased cost of – liquidity, and how these reactions can differ across markets and entities. He expressed brief thoughts on market transparency and transparency to regulators in the context of concerns about liquidity during stress events. He expressed hope that the inherent sophistication of new and complex CCP margin models would be paired with an understanding about what this means for behavior during stress periods.

III. Section 2: CCP Risk and Governance Subcommittee Updates and Reports

Part One: Technology and Operations—Legal Entity Identifiers

Chair Crighton introduced the second workstream of the CCP Risk and Governance Subcommittee.

Mr. Betsill described the composition of the technology and operations workstream and offered updates on the use of legal entity identifiers ("LEIs") and progress on mission-critical third-party vendors. The workstream discussed the industry response to the ION cyber incident and determined that account recovery and the resumption of reporting could be greatly enhanced if the reconciliation process becomes more efficient. The workstream agreed it is beneficial for the industry to move forward with implementing LEIs at the account level. He stated that the workstream encourages the full MRAC to recommend a proposed amendment to CFTC regulation 39.19(i)(A) to accomplish this.

Chair Crighton opened the floor for member discussion, of which there was none.

Part Two: Technology and Operations—Third Party Risk

Mr. Betsill continued that the workstream has developed an inventory of operational oversight efforts globally and has reviewed work by trade associations on the topic of regulating mission-critical third-party vendors. He stated that they would report back on their findings at the next full MRAC meeting.

Mr. Byron described an after-actions findings report released by FIA that outlined lessons learned from the ION ransomware attack, including six recommendations and findings from an industry cyber risk task force formed to review the event and consider how to improve market resilience. He reported that several financial sector groups have developed guidance and frameworks and tools to guide firms through the process of reconnecting in the aftermath of a cyber incident. The task force recommends a review of the guidance which could help to facilitate a more efficient recovery process for industry. The task force also supported the sharing of information with connected parties regarding contingency plans in the event of a cyber incident or other type of outage. The task force recommended that policies regarding risk management practices be calibrated to such factors as the type of service that is provided, the nature of the relationship, and the potential impact of disruption to that service. The task force recommended that FIA form a standing, industry-wide resilience committee to serve as a trusted forum for key stakeholders. The task force also recommended engagement with sector-wide groups on cyber and operational resilience through the work of FIA, and industry participation in regular cyber preparedness exercises.

Ms. Mohr gave an overview of the regulations that pertain to the responsibilities of derivatives clearing organizations ("DCOs") that outsource clearing responsibilities to third parties, and the program that the Division of Clearing and Risk follows when examining DCOs with respect to those third parties. She outlined the requirements of CFTC regulation 39.18(d). Ms. Mohr stated that when assessing third party risks, the Division of Clearing and Risk looks for a DCO to know its vendor and how a DCO monitors and assesses third parties. Ms. Mohr stated that the Division of Clearing and Risk examines the processes and programs of a DCO to ensure that third-party risk is self-identified, regularly monitored, and governed by the same principles that apply to services produced in-house.

Chair Crighton thanked the panelists and opened the floor for member discussion, of which there was none.

Part Three: Recovery and Resolution

Chair Crighton introduced the third panel.

Mr. Cocco acknowledged the full membership of the workstream and stated that they plan to issue a report by spring of 2024. Mr. Cocco covered some of the issues that are planned to be addressed in the report, and stated that the workstream would consider public comments received by the CFTC on the proposed rulemaking on DCO recovery and orderly wind-down plans, as well as international developments such as the EU regulations and the Financial Stability Board ("FSB") financial resources and tools for central counterparty resolution consultation report. He outlined several factors that the workstream will consider in the assessment of CCP recovery tools, including the resilience of the DCOs, Futures Commission Merchants ("FCMs") and clients, interconnectedness of contemporary financial systems, the policy implications of the choices of recovery tools such as risk mutualization, and liquidity. Mr. Cocco then introduced Mr. Blackwell.

Mr. Blackwell stated that international harmonization for large organizations and those that need to hedge in multiple markets is absolutely critical, subject to the legal jurisdiction or bankruptcy laws in place wherever a CCP is headquartered. He then discussed the need for transparency across CCPs.

Chair Crighton next introduced Mr. Wasserman who presented on two topics: first, the FSB's consultation on CCP resources for resolution and the comments on that consultation; and, second, the Commission's proposed rulemaking for DCO recovery and orderly wind down. He explained that the rule proposal was designed to accomplish three goals: to codify existing staff guidance on discovery and wind-down planning for certain DCOs, to establish new wind-down requirements for all other DCOs, and to obtain information for resolution planning. He mentioned the detailed and well-thought-out comments received, and stated that internal discussions were ongoing about the specifics of the final rule.

Chair Crighton thanked the speakers and opened the floor for comments, of which there were none.

Part Four: Margin and Collateral

Chair Crighton introduced the fourth panel, which discussed margin and collateral.

Mr. Senko shared the progress update of the workstream margin and collateral guidelines for the period since 2021. He identified the workstream participants from different parts of the derivatives industry and four workstream topics: transparency of margin requirements, anti-procyclicality, margin period of risk and collateral margin calls. He stated they are assessing market developments, how industry practice has evolved, and known viewpoints on the topics before making recommendations. With respect to transparency, he stated that the overall goal is to enable market participants' liquidity planning and risk management by providing information on margin model reaction to certain market conditions, including how margin calls work, resulting from market developments. The workstream discussed backward-looking procyclicality measures and forward-looking procyclicality disclosures and agreed that CCPs should retain the ability to choose appropriate means to mitigate procyclicality. In terms of margin period of risk, they found the criteria outlined in the 2021 recommendations are mainly still valid and discussed whether to make further or more precise recommendations. Regarding margin calls, the recommendations from the 2021 report remain valid, but suggested that the interrelation with other topics like procyclicality and margin transparency may require that they combine this topic with others.

Chair Crighton paused for member comments. These comments and discussion focused on issues regarding initial and variation margin, segregation, and the default waterfall in the context of recovery and resolution.

III. Section 3—Market Structure Subcommittee Updates and Reports

Part One: Futures Commission Merchant Capacity

Chair Crighton introduced the Market Structure Subcommittee.

Ms. Panse acknowledged the members of the FCM capacity workstream and the Market Structure Subcommittee. The FCM capacity workstream analyzed 20 years of FCM data published on the CFTC's website. The data reflects trends relating to the number of FCMs, activity over the years, client margins, and capital requirements. Ms. Panse stated that there has been some consolidation of FCMs overall, but there is still adequate competition and capacity. Second, she addressed keeping the increasing costs of capital compliance and cyber technology manageable. She provided details on the observed 70 percent decline in the number of FCMs, and stated that the remaining FCMs are dominated by the larger FCM brokers. She discussed the potential effects of recently proposed capital rules like the G-SIB surcharge and the Basel III Endgame. Ms. Panse closed by recognizing the need for appropriate capitalization that takes existing risk mitigants into account in a way that is consistent with broader policy objectives. Ms. Panse invited feedback from the full MRAC.

Chair Crighton focused on the inclusion of the CVA charge for client-cleared derivatives as well as the inclusion of the notional of the client-cleared leg in the G-SIB calculations. She then opened the floor for more feedback and comments. These comments and discussion focused on collecting additional data, the role mergers and acquisitions play in FCM concentration, the demand for clearing and rise in customer funds, and the impact of the proposed Basel III endgame capital rules and amendments.

Part Two: Treasury Market Reform

Chair Crighton introduced the treasury market reform workstream of the Market Structure Subcommittee.

Mr. Schulhofer-Wohl reviewed how experts have been examining how to mitigate the vulnerabilities revealed by stresses in the repo market in 2019 and the dash for cash at the onset of the pandemic in March 2020 and to enhance the resilience of the Treasury markets. In 2021, the Inter-Agency Working Group on Treasury Market Surveillance ("IAWG") staffs proposed six principles to guide public policy in the Treasury markets: resilient and elastic liquidity; transparency that fosters public confidence, fair trading, and a liquid market; prices that reflect prevailing and expected economic and financial conditions; economic integration across cash funding and derivatives markets; financing that does not pose a significant threat to financial stability; and infrastructure that operates effectively and efficiently. He also focused on the potential for expanded central clearing and how clearing relates to the cash futures basis trade in light of the IAWG principles. Mr. Schulhofer-Wohl then discussed the Securities and Exchange Commission's clearing proposal and its potential effect on the costs of customer clearing. He stated that broader central clearing could provide uniformly strong risk management of repos. He concluded by stating that while broader central clearing could have some costs for individual market participants and for market liquidity at normal times, those costs must be weighed against the market-wide benefits, especially at times of stress.

Ms. Battle gave an update on the treasury reform workstream of the Market Structure Subcommittee. She stated that the workstream has specifically focused on topics that affect the derivatives industry, including the significant Treasury futures market at the CME. Ms. Battle stated that as a result of these discussions, the workstream has decided to focus on the Treasury cash futures basis trade and produce a detailed presentation or discussion with the MRAC in 1Q24 and potentially follow up with recommendations and/or best practices for risk management of the basis trading. She welcomed feedback on how the workstream should structure its presentation and outlined next steps.

Ms. Han observed that the Treasury markets are the largest and most liquid government bond markets in the world, with a lot of different market participants. Ms. Han stated that diverse participants help support a robust market. She explained the basis trade, and how it works in the futures market. By providing arbitrage between the cash and futures market, the basis trade increases liquidity, dampens volatility, reduces bid-ask spreads and lowers the cost of government borrowing. Ms. Han discussed the importance of looking at the basis trade as a whole when considering collateralization, leverage, regulatory oversight, and proposals to address risk management. She emphasized there is already oversight and regulation; expanding the scope of who is a dealer and a clearing mandate across the board for Treasurys may have downsides, such as increasing risk to the system, decreasing liquidity, decreasing the number of market participants and increasing the cost of government borrowing.

Chair Crighton thanked the panelists and opened the floor for feedback and comment, of which there were none.

Part Three: Block Implementation Rule

Ms. Battle thanked the members of the workstream and expressed strong support for the CFTC's extension of the new block trade thresholds from December 4, 2023 to July 1, 2024. She described a set of questions for trading venues and data repositories, focused in particular on 10-year U.S. dollar rate swaps and five year CDX, developed by the workstream in order to better understand the volume and trading of market participants currently trading blocks and the implications of the new block sizes. Ms. Battle stated that it is critical to ensure that the dataset used to set block thresholds remains reflective of the market conditions in which those thresholds will apply, and to account for market dynamics during periods of volatility when considering implementation. She added that it is likely that analysis of trading volumes and other data will be required to understand how higher block thresholds will affect market structure and liquidity.

Chair Crighton thanked Ms. Battle and opened the floor for comments, of which there were none.

Part Four: Post-Trade Risk Reduction

Mr. Rowcliffe stated that the Market Structure Subcommittee on post-trade risk reduction anticipates recommending further examination on providing certain exemptions from the Commodity Exchange Act and Commission regulations in January 2024 to enable market participants to use post-trade risk reduction ("PTRR") services more efficiently and optimally. He anticipates that the Subcommittee's submission would explain how market participants will be able to reduce a greater amount of risk in their portfolios if the administrative trades generated as a part of these services were exempt from mandatory clearing, trade execution and real-time reporting requirements. In addition, he stated that the Commission should also consider exempting PTRR service providers from the Swap Execution Facility ("SEF") registration requirements or clarify that PTRR services do not meet the requirements of the SEF definition in specified circumstances. Mr. Rowcliffe outlined anticipated criteria for the proposed exemptions for PTRR services. Mr. Rowcliffe stated that PTRR service providers use more complex products than are necessary, and the anticipated recommendations would make the process simpler and lower the risk even further.

Chair Crighton thanked Mr. Rowcliffe and opened the floor for discussion. The comments and discussion focused on the criteria for obtaining an exemption.

IV. Section 4—Climate Related Market Risk

Chair Crighton introduced the panelists for the fourth section.

Ms. Bent provided a brief summary of proposed CFTC guidance regarding the listing of voluntary carbon credit derivative transactions. She noted Commissioner Johnson's concern that the proposed guidance does not address the significant parts of the environmental commodity market that trade as forwards, spots, or other types of commercial contracts where participants intend to take deliver of the underlying commodity. Vulnerabilities in the markets where these contracts trade may require additional Commission action.

Ms. Mathias provided a view from London on sustainability priorities. She started with the work of the International Sustainability Standards Board and the wider lessons to be learned about the risk of misaligned approaches to sustainability standards and the need for mutual recognition mechanisms. Second, she spoke about transition planning. Ms. Mathias concluded with a few thoughts on voluntary carbon markets.

Chair Crighton thanked the panelists and opened the floor to the MRAC members for discussion, of which there was none.

V. Section 5—Future of Finance

Chair Crighton introduced the panelists for the fifth and final section of the meeting.

Ms. Massari identified and discussed four topics that she views as good candidates for further exploration by the Future of Finance Subcommittee: vertical integration, risk management and governance, cyber resilience, and decentralized or digital IDs and verified credentials.

Mr. Werbach identified and discussed two areas of engagement for the Future of Finance Subcommittee: blockchain and artificial intelligence ("AI"). With regard to blockchain and digital assets, discussion worthy topics include the mechanisms for risk management and technology-informed regulation. Under the category of AI, Mr. Werbach cited generative AI, the risks that arise using AI systems in trading, and systemic risk. He then discussed how blockchain and AI might come together, and the risks that such convergence might pose.

Chair Crighton then opened the floor to the broader MRAC committee for discussion. There was one comment which focused on the parallelism between digital assets and the foreign exchange market.

VI. Adjournment

Chair Crighton and Commissioner Johnson thanked the participants and CFTC staff who helped with the meeting.

Mr. Janowski adjourned the meeting at 12:56 p.m.

A Crighton
Alicia Crighton
MRAC Chair

9/3/24
Date