1 COMMODITY FUTURES TRADING COMMISSION

2

3

4

5

6 Global Markets Advisory Committee Meeting

7

8

9

10

11 8:45 a.m. EST

12 Monday,

13 October 25, 2021

14

15

16

17

18

19

20

21 TELECONFERENCE

22

1 PARTICIPANTS

2

3 CFTC COMMISSIONERS

4 Commissioner Dawn D. Stump (GMAC Sponsor)

5 Acting Chairman Rostin Behnam

6

7 GLOBAL MARKETS ADVISORY COMMITTEE MEMBERS

8 Angie Karna (GMAC Chair)

9 Nomura Securities International, Inc.

10

11 Chris Allen

12 Standard Chartered Bank

13

14 Ted Backer

15 Morgan Stanley

16

17 Ashley Belich

18 RBC Capital Markets

19

20 Darcy Bradbury

21 D.E. Shaw & Co., L.P.

22 PARTICIPANTS (CONTINUED)

1
2 Gerry Corcoran
3 R.J. O'Brien & Associates, LLC
4
5 Sunil Cutinho
6 CME Clearing
7
8 David Goone
9 Intercontinental Exchange, Inc.
10
11 Paul Hamill
12 Citadel Securities
13
14 Amy Hong
15 Goldman Sachs
16
17 John Horkan
18 LCH Group
19
20 Adam Kansler
21 IHS Markit
22 PARTICIPANTS (CONTINUED)

1
2 Robert Klein
3 Citigroup Global Markets
4
5 Agnes Koh
6 Singapore Exchange Limited
7
8 Janet Kong
9 BP Americas
10
11 Ben MacDonald
12 Bloomberg LP
13
14 Erik Tim Müller
15 Eurex Clearing AG
16
17 Joseph Nicosia
18 Louis Dreyfus Company
19
20 Murray Pozmanter
21 DTCC
22 PARTICIPANTS (CONTINUED)

1 Thomas Sexton
2 National Futures Association
3
4 Maggie Sklar
5 Federal Reserve Bank of Chicago
6
7 Jessica Sohl
8 HC Technologies
9
10 Thane Twiggs
11 Cargill Risk Management
12
13 Supurna VedBrat
14 BlackRock
15
16 Masahiro Yamada
17 JP Morgan Securities, LLC
18
19
20
21
22 A G E N D A

1 Page
2 Welcome and Opening Remarks: 11
3 Commissioner Dawn D. Stump (GMAC Sponsor) 12
4 Acting Chairman Rostin Behnam 21
5
6 Roll Call 18
7
8 Panel 1:
9 Treasury Market Structure and Recent Stresses 22
10 Presenters:
11 Sam Schulhofer-Wohl, Senior Vice President
12 and Director of Financial Policy and Outreach,
13 Federal Reserve Bank of Chicago 23
14
15 Michael Pedroni, Executive Vice President
16 and Managing Director, Head of Global Research
17 and Markets, Managed Funds Association (MFA) 34
18
19 Jennifer Han, Chief Counsel and Head of
20 Regulatory Affairs, Managed Funds
21 Association (MFA) 50
22 A G E N D A (CONTINUED)

1 Page

2 Break 64

3

4 Panel 2:

5 Clearing in the Treasury Market 64

6 Presenters:

7 Professor Darrell Duffie, Adams Distinguished

8 Professor of Management and Professor of

9 Finance, Graduate School of Business, Stanford

10 University 65

11

12 Graham Harper, FIA Principal Traders Group

13 Executive Committee Member and Head of Public

14 Policy and Market Structure, DRW Trading Group 71

15

16 Laura Klimpel, General Manager, Fixed Income

17 Clearing Corporation 77

18

19

20 Break 113

21

22 A G E N D A

1 Page
2 Panel 3:
3 Dodd-Frank Act Implementation 113
4 Presenters:
5 Tara Kruse, Global Head of Infrastructure,
6 Data and Non-Cleared Margin, International
7 Swaps and Derivatives Association, Inc.
8 (ISDA) 113/125
9
10 Kyle Brandon, Managing Director, Head of
11 Derivatives Policy, Securities Industry
12 and Financial Markets Association (SIFMA) 122/146
13
14 Colin Lloyd, Partner, Cleary Gottlieb
15 Steen & Hamilton LLP 137
16
17 Closing Remarks:
18 Commissioner Dawn D. Stump (GMAC Sponsor) 156
19
20 Adjourn 161
21
22 P R O C E E D I N G S

1 (8:46 a.m. EST)
2 OPERATOR: Welcome and thank you all for standing
3 by. At this time, all participants will be in a
4 listen-only mode. Today's conference is being
5 recorded. If you have any objections, you may
6 disconnect at this time.
7 I would like to turn the conference over to Andree
8 Goldsmith. Thank you. You may begin.
9 MS. GOLDSMITH: Thank you very much. This is
10 Andree Goldsmith. Good morning, everyone.
11 As the Designated Federal Officer for the Global
12 Markets Advisory Committee, it's my pleasure to call
13 this meeting to order. I'd like to welcome everyone to
14 today's meeting. In light of the global response to
15 COVID-19, we're holding today's meeting as a virtual
16 meeting to protect the safety of agency personnel, GMAC
17 members, guests, panelists, and the public.
18 To ensure that today's meeting goes as smoothly as
19 possible, there are a few logistical items that I would
20 like to mention. Because this is a virtual meeting
21 it's also being broadcast in a live stream on the
22 internet, so please be sure to identify yourself before

1 speaking. Also, please signal when you have completed
2 your comments so that we can continue with the next
3 speaker or question. Please ensure that your phone is
4 un-muted before you start to speak, that you speak
5 clearly into your phone and that you re-mute your line
6 when you are done speaking.
7 For GMAC members and Commissioners, if you would
8 like to be recognized during the discussion, please use
9 the WebEx chat icon at the bottom of the screen, select
10 the all panelists option within the dropdown menu,
11 indicate that you have a comment or question and press
12 enter.
13 If any meeting participant needs assistance during
14 the call, please dial star-zero to connect to the
15 conference operator or message me directly within the
16 WebEx chat.
17 Finally, please keep your telephone line muted
18 when you're not speaking. If you do not mute your
19 line, the conference operator may need to mute it for
20 you.
21 I'd now like to turn things over to the GMAC
22 Sponsor Commissioner Dawn Stump for her opening

1 remarks.
2 COMMISSIONER STUMP: Good morning. Thanks Andree.
3 And welcome everyone to today's meeting of the CFTC
4 Global Markets Advisory Committee. I want to begin by
5 thanking Acting Chairman Benham for attending today's
6 meeting. And I also want to recognize that due to the
7 global nature of this committee, there are many
8 participants in less than ideal local time zones, and I
9 am extremely grateful for their willingness to do so.
10 I would especially like to thank all of today's
11 esteemed presenters for being here and for taking the
12 time out of your busy day to contribute to our
13 discussion. Additionally, I would like to thank Chair
14 Angie Karna for the leadership of the GMAC and Andree
15 Goldsmith, the GMAC’s Designated Federal Officer, not
16 only for her tremendous efforts in organizing today's
17 meeting, but her assistance with the GMAC over the past
18 three years. Today markes Andree's last GMAC meeting
19 as she will soon depart the CFTC, and I for one am very
20 sad to see her go, but I know she will do amazing
21 things in her next chapter.
22 I know I speak for every member of the committee

1 in expressing gratitude for Andree's remarkable ability
2 to ensure we always enjoy a complete, diverse, and
3 global membership ready to engage in a variety of
4 topics. Her job is not an easy one and her shoes will
5 be hard to fill. Thank you, Andree, very much for your
6 help over the past three years with the GMAC.
7 Turning to today's meeting, I wanted to just go
8 over briefly what we will be covering. We have three
9 panels. The first two of which will focus on the U.S.
10 Treasury market. Because of the interconnectedness
11 between the Treasury market and the derivatives market,
12 the health and the efficient function of the Treasury
13 market is vitally important to the integrity,
14 resilience, and vibrancy of the market we oversee here
15 at the CFTC.
16 Because of these interconnections, I thought it
17 important to focus much of our discussion today on the
18 recent stresses in the U.S. Treasury market and the
19 various proposals and recommendations that have been
20 made to mitigate such in the future. In that regard
21 panel one will feature two presentations.
22 First, we will hear from Sam Schulhofer-Wohl,

1 Senior Vice President and Director of Financial Policy
2 and Outreach at the Federal Reserve Bank of Chicago,
3 who will discuss some of the recent events that have
4 affected the Treasury market.
5 Next we will hear from Michael Pedroni, Executive
6 Vice President and Managing Director, Head of Global
7 Research and Marketing. And Jennifer Han, Chief
8 Counsel, and Head of Regulatory Affairs, both of the
9 Managed Funds Association.
10 We are grateful they are willing to share the
11 experience of the MFA's membership as it was like to
12 the recent events in the Treasury market, as well as
13 their view on some of the reforms being discussed.
14 The second panel will feature three presentations
15 that we'll dive deeper into one of the most discussed
16 proposals for reforming the U.S. Treasury market,
17 increased central clearing. The panel will start with
18 Professor Darrel Duffie, Adams Distinguished Professor
19 of Management and Professor of Finance at the Graduate
20 School of Business at Stanford University.
21 Then next presenter, Mr. Graham Harper will
22 discuss central clearing of Treasury from the

1 perspective of principal trading firms. Mr. Harper is
2 a member of the Executive Committee of FIA Principal
3 Traders Group, and Head of Public Policy and Market
4 Structure at DRW Trading Group.
5 And we will hear from Laura Klimpel, General
6 Manager at the Fixed Income Clearing Corporation, who
7 will discuss six various clearing models and how they
8 may be able to support increased central clearing of
9 Treasury transactions.
10 For the third panel, we will pivot to a discussion
11 of recent development in the CFTC's continued
12 implementation of the Dodd-Frank Act. Our presenters
13 for panel three, are Tara Kruse, Global Head of
14 Infrastructure, Data, and Non-Cleared Margin at ISDA;
15 Kyle Brandon, Managing Director, Head of Derivatives
16 Policy at SIFMA; and Colin Lloyd, Partner at Cleary,
17 Gottlieb, Steen, and Hamilton.
18 Together our presenters will discuss the recent
19 implementation efforts of various Dodd-Frank
20 rulemaking, including swap data reporting, margin
21 requirements for non-cleared swaps, and swap dealer
22 capital substituted compliance.

1 Out panelists will focus on the implementation
2 challenges faced by market participants, as well as
3 some of the recommendations that have been made to
4 alleviate these challenges. I'm very much looking
5 forward to this morning presentations, and again, I
6 wish to thank all the members of the committee, as well
7 as the panelists for being here today in furthering
8 these important conversations, and our GMAC members
9 will no doubt have a robust discussion and an engaging
10 dialogue.
11 So thanks to everyone for being here. And I look
12 forward to the discussion. Back to you Andree.
13 MS. GOLDSMITH: Thank you Commissioner Stump.
14 Chairman Behnam.
15 ACTING CHAIRMAN BEHNAM: Andree, thanks. And
16 good morning and potentially good afternoon and good
17 evening to some who are listening across the globe.
18 It's wonderful to be here.
19 First, thanks to Commissioner Stump, of course, as
20 sponsor of the GMAC for her leadership and really the
21 vision for an excellent dialogue today. And as we've
22 had in the past, this is going to be a wonderful

1 discussion.
2 A special thanks to Andree Goldsmith and best of
3 luck to you, Andree, in your next chapter as
4 Commissioner Stump said. And of course, thanks to
5 Angie Karna as well for her leadership as Chair of the
6 GMAC.
7 Today's discussion is as pertinent as they get.
8 And as usual for the GMAC, I'm very interested to hear
9 about the Treasury market discussion, not only because
10 of what we experienced in the sort of peak March-April
11 2020 period, but certainly what we've had in terms of
12 experiences in the Treasury market and the relationship
13 between cash and derivatives, really in the past decade
14 and even more. So there's going to be a lot to learn
15 in the conversation about clearing.
16 Again, as relevant as we get as a lot of those
17 discussions are very active within the policy group.
18 So a great panel of speakers that will have
19 different points of view and certainly help inform the
20 CFTC is we play our part in that larger discussion and
21 evolution of the Treasury markets.
22 And then quickly just commenting on the last

1 panel. So much has happened at the Commission in the
2 past few years. And certainly if we look back to 2010,
3 implementation of Dodd-Frank has been a challenge at
4 part, but a success in many parts as well. But it's
5 never too late, but also we should always focus on, in
6 my view, consistently reviewing rules and policies so
7 that the markets are functioning the best that they can
8 and that there's sufficient transparent markets, but
9 also ones that are serving customers and end users.
10 So I think this is going to be a timely discussion
11 as we're moving forward with a new agenda in the few
12 years to come and certainly I look forward to working
13 with Commissioner Stump and the GMAC with any findings
14 or conclusions that this committee or this particular
15 group may have.
16 So thanks again to all who are participating in
17 listening and thanks to the panelists for their
18 willingness to share their views and thoughts. And
19 again, thanks to Commissioner Stump for her leadership
20 on this conversation today. Thank you.
21 MS. GOLDSMITH: Thank you. Acting Chairman.
22 Thanks again to the Commissioners for taking part

1 in this meeting of the GMAC and for sharing your
2 remarks with the committee.
3 Before we begin with our presentation today, I'd
4 like to do a quick roll call of the GMAC members on the
5 phone so that we have your attendance on the record.
6 After I say your name and firm, please indicate that
7 you are present.
8 Chris Allen, Standard Chartered.
9 MR. ALLEN: Yes, I'm here. Hi.
10 MS. GOLDSMITH: Thank you. Ted Backer, Morgan
11 Stanley.
12 [No response.]
13 MS. GOLDSMITH: Ashley Belich, RBC Capital
14 Markets.
15 MS. BELICH: Yes, present.
16 MS. GOLDSMITH: Thank you. Shawn Bernardo, TPI
17 ICAP SEF.
18 [No response.]
19 MS. GOLDSMITH: Darcy Bradbury, D.E. Shaw and Co.
20 MS. BRADBURY: Present.
21 MS. GOLDSMITH: Thank you. Maria Chiodi, Credit
22 Suisse Securities.

1 [No response.]

2 MS. GOLDSMITH: Joseph Cisewski, Better Markets.

3 [No response.]

4 MS. GOLDSMITH: Jim Colby, Coalition for

5 Derivatives End-Users.

6 [No response.]

7 MS. GOLDSMITH: Gerry Corcoran, R.J. O'Brian and

8 Associates.

9 MR. CORCORAN: Present.

10 MS. GOLDSMITH: Thank you. Sunil Cutinho, CME

11 Clearing.

12 MR. CUTINHO: Hi, I’m present.

13 MS. GOLDSMITH: Good morning. David Goone,

14 Intercontinental Exchange

15 MR. GOONE: Present.

16 MS. GOLDSMITH: Thank you. Paul Hamill, Citadel

17 Securities.

18 [No response.]

19 MS. GOLDSMITH: Amy Hong, Goldman Sachs.

20 MS. HONG: Present.

21 MS. GOLDSMITH: Thank you. John Horkan, LCH

22 Group.

1 MR. HORKAN: Present.
2 MS. GOLDSMITH: Thank you. Adam Kansler, IHS
3 Market.
4 MR. KANSLER: Good morning, present.
5 MS. GOLDSMITH: Good morning, thank you. Angie
6 Karna, Nomura Securities International.
7 CHAIR KARNA: I'm present Andree. Thank you.
8 MS. GOLDSMITH: Thank you. Bob Klein, Citigroup
9 Global Markets.
10 MR. KLEIN: I'm present, thank you.
11 MS. GOLDSMITH: Thank you. Agnes Koh, Singapore
12 Exchange.
13 MS. KOH: Present.
14 MS. GOLDSMITH: Thank you Agnes. Janet Kong, BP
15 Americas.
16 MS. KONG: Present.
17 MS. GOLDSMITH: Thank you. Ben MacDonald,
18 Bloomberg.
19 MR. MACDONALD: Present.
20 MS. GOLDSMITH: Thank you. Erik Müller, Eurex
21 Clearing.
22 MR. MÜLLER: Good morning, present.

1 MS. GOLDSMITH: Good morning, thank you. Joe
2 Nicosia, Louis Dreyfus Company.
3 [No response.]
4 MS. GOLDSMITH: Murray Pozmanter, DTCC.
5 [No response.]
6 MS. GOLDSMITH: Thomas Sexton, NFA.
7 MR. SEXTON: Good morning, present.
8 MS. GOLDSMITH: Good morning. Thank you. Maggie
9 Sklar, Federal Reserve Bank of Chicago.
10 [No response.]
11 MS. GOLDSMITH: Jessica Sohl, HC Technologies.
12 [No response.]
13 MS. GOLDSMITH: Thane Twiggs, Cargo Risk
14 Management.
15 MR. TWIGGS: Good morning, I'm present.
16 MS. GOLDSMITH: Good morning. Supurna VedBrat,
17 BlackRock.
18 MS. VEDBRAT: Present.
19 MS. GOLDSMITH: Thank you. And Masahiro Yamada,
20 JP Morgan.
21 MR. YAMADA: Good morning, I'm present.
22 MS. GOLDSMITH: Good morning. If I did not

1 acknowledge your presence on the call. Please email me
2 or message me directly in the WebEx chat to confirm
3 your attendance for the record.
4 With that, I'd like to turn the program over to
5 Angie Karna, Chair of the GMAC for an introduction of
6 our presenters on the panel one. Go ahead, Angie.
7 CHAIR KARNA: Thank you Andree. Just a few
8 logistical reminders. Please keep your phones on mute
9 while you are not speaking. Following the
10 presentations, if a GMAC member or Commissioner would
11 like to be recognized to speak, please use the WebEx
12 chat icon at the bottom of the screen, then select the
13 all panelists option within the dropdown menu.
14 Indicate that you have a question and press enter.
15 Please identify yourself and your firm prior to
16 speaking and indicate when you are finished speaking.
17 Our first panel will focus on the recent stresses
18 in the Treasury market and the reform proposals and
19 recommendations that have been made to mitigate against
20 future stresses.
21 Our first presenter is Sam Schulhofer-Wohl, Senior
22 Vice President and Director of Financial Policy and

1 Outreach at the Federal Reserve Bank of Chicago.
2 Please go ahead.
3 MR. SCHULHOFER-WOHL: Thank you Chair Karna. And
4 thank you to Commissioner Stump and Ms. Goldsmith for
5 the kind invitation to speak with you today. As you
6 noted, my name is Sam Schulhofer-Wohl and I am Senior
7 Vice President and Director of Financial Policy and
8 Outreach at the Federal Reserve Bank of Chicago. I
9 oversee our research and policy analysis on financial
10 markets, especially derivatives, as well as our
11 community development and public affairs programs.
12 I've been asked to speak about recent dislocations
13 in the Treasury market and the path forward for
14 improving market resilience. As always the views I
15 express are mine and not necessarily those that the
16 Chicago Fed or the Federal Reserve system, and also
17 because there was a Federal Open Market Committee
18 meeting next week, our communications blackout rules
19 limit the topics that I can discuss.
20 I will not be commenting on current or prospective
21 economical and financial conditions or current or
22 prospective uses in the Federal Reserve's policies and

1 tools. No inference should be drawn for my silence on
2 these matters.
3 I also will not be in there to answer questions
4 today. But I very much value dialogue and would
5 welcome the opportunity to engage with you further
6 outside the blackout period.
7 With those disclaimers out of the way, let me turn
8 to Treasury market resilience. The Treasury markets
9 serve many vital purposes. It is a source of financing
10 for the government. It provides safe and liquid assets
11 for savers and investors. It establishes a risk-free
12 yield curve and more. Both the financial system and
13 the American people benefit from the market's
14 considerable strengths.
15 It is as this audience knows, the deepest and most
16 liquid market in the world. Nevertheless, there have
17 been some significant dislocations in recent years, and
18 we can try to learn from these events to make the
19 market more robust.
20 I'll discuss two events. The March 2020 pandemic
21 stresses and the September 2019 repo market pressures.
22 Each event was unique, but there are some common

1 threads and I want to highlight one in particular that
2 might shed some light on resilience. That common
3 thread is the behavior of supply and demand for
4 liquidity.
5 In March 2020, as the COVID-19 pandemic spread
6 people around the world faced an extraordinary threat
7 to their lives, health, and livelihoods. Actions taken
8 to control the spread of the virus led to extreme
9 disruptions of economic activity. Financial markets
10 reacted with severe volitility. After an initial
11 period of typical flight to safety inflows into
12 Treasury securities, these highly uncertain
13 circumstances caused broad-based and rapid sales of
14 treasuries, especially seasoned securities with longer
15 maturities.
16 Overall, there appear to have been three distinct
17 sources of these sales: First, in the face of economic
18 and financial stress many market participants sold
19 their most liquid non-cash assets, frequently, Treasury
20 securities, to obtain cash and cash-like assets such as
21 Treasury bills. These sellers included mutual funds
22 meeting redemptions, foreign central banks considering

1 currency interventions, and traders covering margin
2 calls among others.
3 Second, some market participants were motivated to
4 unwind positions when the volatile environment changed
5 the economics of certain trades. For example,
6 Treasury cash futures basis positions became riskier
7 and more costly amid uncertainty about funding
8 availability, the risk of large variation margin calls,
9 and higher initial margin requirements intended to
10 protect central counterparties against the increased
11 market risks.
12 Third, precautionary concerns amplified the
13 initial rush of sales. For example, as it became clear
14 that the sales were challenging market function some
15 Treasury holders appeared to sell not because they
16 needed cash immediately but in order to guard against
17 the risk that market functioning would deteriorate
18 further. Someone who wants to sell treasuries needs to
19 find a buyer typically through an intermediary who
20 provides market liquidity. So the broad-based desire to
21 sell treasuries was effectively a dramatic increase in
22 the demand for intermediation. On the whole,

1 intermediaries, such as dealers and principal trading
2 firms greatly increased their activity to meet this
3 demand as reflected in the large increases in trading
4 volumes in the Treasury market in March 2020.
5 However, there were limits to intermediary
6 capacity. These limits appear to have reflected in
7 large part the interaction with the extreme market
8 volatility and uncertainty with intermediaries' risk
9 appetites and business strategies. And in some cases,
10 the influence of regulations on these. In this
11 context, bid-ask spread and other measures of
12 liquidity, such as the price impact of trades reached
13 the worst level since the Global Financial Crisis. The
14 market stress resolved only after the Federal Reserve
15 purchased Treasury securities on an unprecedented scale
16 and following additional forceful actions by the
17 Federal Reserve, Treasury Department, and Congress to
18 support smooth market functioning and to aid the
19 economy.
20 You can think of measures like the bid-ask spread
21 as indicators of the price of market liquidity. If the
22 bid-ask spread is wider, intermediaries can make more

1 money by taking both sides of the market and it costs
2 end-users more to get in and out of positions.
3 To sum up, in March 2020 in the Treasury market,
4 the demand for intermediation went up, the supply of
5 intermediation went up, and the price of intermediation
6 went way up. As an economist, I think that the rising
7 prices providing powerful incentives. The bid-ask
8 spread and other measures showed that there was a lot
9 of money to be made by intermediating and a big cost to
10 trading as an end-user. And yet, despite the powerful
11 incentives, the supply and demand for market liquidity
12 did not respond enough to avoid market stress, perhaps
13 that simply reminds us just how large the pandemic
14 shock was.
15 Now let's turn to September 2019. On the 16th of
16 that month a quarterly tax payment date and the
17 settlement of Treasury auction drained funds from the
18 financial system, even if the auction settlements
19 increased some institutional need for funds. Earlier
20 in the month, repo rates had been trading a bit below
21 two and a quarter percent, but on the morning of the
22 17th rates spiked as high as nine percent on some

1 trades and the secured overnight financing rate, or
2 SOFR, settled at five and a quarter percent. Up 282
3 basis points from the day before.
4 Rate pressure spilled over to other money markets,
5 such as federal funds and subsided only after the
6 Federal Reserve carried out large scale repo
7 operations. A repo interest rate like SOFR is the
8 price of funding liquidity, the ability to use an asset
9 as collateral.
10 And if we can turn to the next slide, please, I'd
11 like to show you a familiar, but still remarkable graph
12 of this price.
13 This graph shows SOFR, as well as the volume of
14 transactions used to compute it, basically all
15 overnight general collateral tri-party and centrally
16 cleared bilateral Treasury repos. You can see the
17 spike in rates on September 17th. And if you look
18 really closely at the volumes on the 17th, you can see,
19 well, you can see that nothing much happened.
20 The supply and demand for funding liquidity were not
21 particularly responsive to the price of funding
22 liquidity. And so, the price, the interest rate, had

1 to rise enormously for the market to clear.
2 Now these dynamics are pretty different from what
3 we saw in March 2020. The shock in September 2019,
4 wasn't nearly so large. Rather a major factor appears
5 to have been that even though the overnight repo market
6 reprices every day, it was difficult for participants
7 to significantly change their activities from one day
8 to the next. Borrowers needed to fund their assets and
9 couldn't quickly exit positions at a reasonable price,
10 at least in the short run, it made sense to pay very
11 high repo rates to get funding.
12 Lenders often relied on relationships with
13 particular borrowers and trading desks operated within
14 limits based on the institution's overall strategy for
15 deploying its balance sheet. So it was difficult to
16 rapidly ramp up lending when rates were spiking.
17 But even though the dynamics in September 2019 and
18 March 2020 are different there still is the common
19 thread that at times supply and demand for liquidity
20 haven't adjusted enough to keep the price of liquidity
21 from soaring. We can think about some potential
22 improvements in light of that pattern.

1 As I mentioned, I cannot speak today about current
2 and prospective Federal Reserve policies and tools. I
3 will instead note three other areas that researchers,
4 market participants, or agencies have discussed
5 publicly. All of these in my view may affect the
6 responsiveness of liquidity supply and demand in the
7 Treasury market.
8 First, there have been calls to improve the
9 collection and increase the public dissemination of
10 market data. Treasury futures as an exchange-traded
11 and fully centrally-cleared market are subject to
12 extensive data collection and reporting, but there are
13 gaps in data for the cash and repo markets.
14 For example, in the repo market we have extensive
15 data on the tri-party and clear bilateral segments, but
16 the official sector has not collected systematic data
17 on uncleared bilateral repo transactions since a pilot
18 project in 2015. Improvements in data collection and
19 transparency could make the market more resilient and
20 elastic in a couple of ways.
21 For the official sector, more complete and timely
22 data may enable more nimble responses when stress

1 emerges, as well as allow for better design of policies
2 ex ante. For the private sector, appropriate data
3 transparency may remove uncertainty and support more
4 responsive trading. So the potential for transparency
5 to interfere with liquidity provision must also be
6 considered.
7 Second, there have been calls to consider
8 expansion of central clearing in the Treasury market.
9 Treasury futures are centrally cleared, but not all
10 repos and cash transactions are. As long experience in
11 cleared markets has demonstrated, and as research by my
12 colleagues in the Chicago Fed's Financial Markets Group
13 has found, central clearing in general has two major
14 benefits: improved risk management and multi-lateral
15 netting. Both of these, again, speaking generally, has
16 the potential to support more responsive trading
17 dynamics by making intermediation safer and, in some
18 circumstances, less balance sheet intensive.
19 However, much depends on the institutional details
20 of a particular market, and the precise effects of
21 broader clearing in the Treasury cash and repo markets
22 merit careful study. Moreover, central clearing

1 concentrates risk as the central counter-party so
2 continued strong risk management, regulation, and
3 supervision will be crucial.
4 I'm looking forward to today's second panel, which
5 I understand will delve into central clearing of
6 treasuries in more detail.
7 Finally, there have been suggestions to reconsider
8 how Treasury trading values are regulated. For
9 example, the Security Exchange Commission has proposed
10 extending Regulations ATS and SCI to alternative
11 trading systems for government securities.
12 These regulations provide investor protections and
13 safeguards for reliability of electronic and automated
14 systems in other markets. Extending this oversight to
15 Treasury alternative trading systems could help to
16 support access to and reliability on these heavily used
17 trading venues.
18 There are, of course, many other possibilities for
19 enhancing the resilience of the Treasury market.
20 Additionally, while I've highlighted the role of
21 supply and demand for liquidity in some recent events,
22 this is a large and complicated market with many

1 drivers. The lens I’ve offered is certainly not the
2 only one that could be used to consider how the market
3 might be strengthened, but I hope this perspective is
4 helpful to you and I look forward to further
5 discussion. Thank you.
6 CHAIR KARNA: Thank you, Mr. Schulhofer-Wohl. The
7 next presenters are Michael Pedroni, Executive Vice
8 President and Managing Director, Head of Global
9 Research and Markets and Jennifer Han, Chief Counsel,
10 and Head of Regulatory Affairs, both from the Managed
11 Funds Association. Please go ahead.
12 MR. PEDRONI: Thank you very much. I want to --
13 this is Michael Pedroni. I want to thank Chair Behnam,
14 Commissioner Stump, and the entire GMAC, as well as the
15 GMAC Chair Angie Karna, and Andree Goldsmith, as well
16 for inviting the MFA to today's session.
17 We want to present our research and latest
18 thinking on Treasury markets, what happened during the
19 COVID shock of March 2020, and what are the reforms we
20 believe are needed to modernize the Treasury markets.
21 I'll start by providing an analysis of the
22 Treasury market with a focus on the unique features

1 that we believe prompted the unprecedented movements,
2 or at least contributed to them that began in
3 particular on March 9th, 2020, when Treasury prices --
4 that was the date when Treasury prices began to fall in
5 tandem with the equity markets.
6 My colleague, Jennifer Han, will then build on
7 this to share our perspectives on what can be improved
8 to enhance the liquidity and functioning of the
9 Treasury markets even in times of shock. It goes
10 without saying, just as the previous presenter was
11 indicating, that we all need the Treasury markets to
12 continue to function as effectively as possible.
13 Andree, if you don't mind flipping to slide number
14 two.
15 There were four attributes of the Treasury markets
16 in recent events and then one key observation that
17 grows out of that, that we think should inform any
18 policy reforms going forward.
19 First, Treasuries are not a uniform market and
20 each type of Treasury trades differently due to the
21 market structure and practice. Second, the lesson that
22 many market participants seem to have learned from the

1 Global Financial Crisis of 2008, was to lock in dollar
2 liquidity. And the same thing happened in March 2020,
3 as particularly non-U.S. market participants engaged in
4 a dash for dollars. Third, Treasury markets, and
5 especially secondary markets, rely on more market
6 participants than before the Global Financial Crisis.
7 Fourth, repo is far too reliant on bilateral
8 relationships. And then fifth, because of these
9 attributes, we believe that expanded clearing options,
10 including for repo are part of the answer to
11 modernizing Treasury markets.
12 And Andree, if you could flip to slide three.
13 Let's start then with that point, that Treasuries
14 are not a uniform market markets. And if you think of
15 the markets for the on the run issues, they're very
16 liquid, mostly automated, and highly efficient. But on
17 the runs account for just about three percent of total
18 issuance, outstanding, even though in normal times they
19 represent 75 percent of the daily volume traded.
20 So that's on the runs.
21 Off the run issues representing 97 percent of
22 outstanding issuance, but are far less liquid and are

1 often held as a store of value by long-term buy and
2 hold investors, including foreign central banks. They
3 are traded by various means, including traditional
4 voice brokering and electronic RFQs. Third, we have
5 cheapest to deliver issues. For example, those that
6 are most economical to use for delivering into the
7 active CME futures contracts and those trades with the
8 liquidity premium. And then fourth, of course, futures
9 are derivative contracting.
10 I go through this importantly because each of
11 these four buckets performed differently in response to
12 the COVID shock.
13 So let's take a look at look at that in slide
14 four.
15 So this shows on the run versus off the run
16 transaction volumes. The on the run asset is
17 strikingly different than the off the run asset. As
18 you can see in this chart, the average number of times
19 that the entire outstanding amount of the on the run
20 issues is transacted in a week is exponentially more
21 than all of the off the runs. And this is trace data,
22 incidentally.

1 So looking at the two-year note, the size of the
2 recent issue of the two-year note was 66 billion. That
3 that figure is not represented on this chart, but what
4 we want to point out is that over the course of the
5 week, about 128 billion of this two-year note was
6 transacted. So roughly 200 percent, 195 percent.
7 Equivalent to twice the amount of the outstanding.
8 If you look at the ten-year note, it's even more
9 heavily traded. The 400 -- the 628 percent there,
10 represents 440 billion transacted weekly as compared to
11 the outstanding 70 billion amount of the issue.
12 And then if you look at the second bars, next to
13 each of the tall bars, those are the off the runs.
14 And as you can see, they barely transact.
15 So very, very different liquidity features between
16 these two markets.
17 Now, if you turn to slide five, please. You know,
18 one of the attributes that I mentioned at the top is
19 that there are multiple sellers in the Treasury
20 markets, multiple participants. And so, let's turn to
21 the dash for dollars in March and let's examine who
22 those sellers are.

1 We know from the macro data that a net 635 billion
2 in Treasuries were sold in March of 2020. The Federal
3 Reserve in its November 2020 financial stability report
4 tells us that about 400 billion was sold by non-U.S.
5 accounts amid this dash for dollars, including about
6 216 billion by central banks, foreign central banks.
7 Recall that in addition to the COVID shock, oil
8 exporting countries were also experiencing a crash in
9 the price of oil, even briefly below zero. So
10 consistent with that, we can see in the Treasury
11 international capital data for March 2020, that Saudi
12 Arabia was the largest net seller and a significant
13 component of that foreign official account slice of 34
14 percent.
15 These details are important to note because
16 central banks are usually buyers and holders of off the
17 run Treasuries, they warehouse these Treasuries as a
18 store of value, but suddenly in March, they began
19 selling these warehoused off the runs en masse in order
20 to try and raise dollar liquidity and this dash for
21 cash through traditional relationships between off the
22 runs and other off the runs sharply out of balance.

1 So in March 2020, just as bank dealers were
2 migrating their trading operations to their homes, a
3 wave of largely voice traded paper number, remember
4 these are deeply off the run issues, went flooding into
5 the markets from central banks, private foreign
6 accounts, and others.
7 And given the desks were --
8 [Pause.]
9 CHAIR KARNA: Mr. Schulhofer-Wohl, are you on?
10 MR. SCHULHOFER-WOHL: Yes. I believe Mr. Pedroni
11 was speaking.
12 CHAIR KARNA: Oh, sorry. Mr. Pedroni, are you on?
13 [No response.]
14 CHAIR KARNA: Ms. Han, are you on?
15 MS. HAN: Yes, I am on. I'm just checking on my
16 colleague to see what happened to his line.
17 MR. PEDRONI: Hi.
18 OPERATOR: And I have just joined in back in.
19 CHAIR KARNA: Okay, great. Mr. Pedroni.
20 MR. PEDRONI: Yes. Thank you. Thanks so much for
21 that. I don't know what happened there, other than
22 that the phone line just suddenly dropped.

1 So I think the last thing that I was talking about
2 was the fact that bank desks were moving off site just
3 as a lot of voice brokered paper was hitting the
4 markets and that this caused a significant disarray in
5 the market for off the run issues.
6 So with that, if we can move to slide six then.
7 So I want to focus a little bit more on these
8 deeply off the runs around Treasury issues and how they
9 experienced that March 9th through, the most acute
10 period was March 9th through March 13th. March 13th
11 was significant because that was the date when the Fed
12 began purchasing not only a basket of Treasuries, but
13 importantly began to purchase cheapest to deliver
14 issues. And I'll talk a bit more about why that became
15 so important.
16 So this is kind of microscopic a week that we look
17 at to understand the features and the price data. So
18 what this slide shows then is that is the disarray that
19 I was just describing. You know, and we believe that
20 this foreign central bank selling was a major factor in
21 the turmoil.
22 The yield spreads on the first through seven off

1 the run issues against the on the run ten-year note,
2 which is what's depicted here, suddenly became sharply
3 misaligned, including against each other. So normally
4 as you can see in the lead up to March 9th this
5 relationship is highly predictable and it's determined
6 by liquidity and remaining maturity of the issues.
7 Now, as you can see, by March 9th, as these
8 normally predictable relationships were completely out
9 of whack. For example, I'd like to draw your eye to
10 the behavior of the fifth off the run issue which is
11 depicted, I believe in green. Please bear with me.
12 I'm slightly color blind, but I believe that’s green.
13 So in the pre-COVID shock period, it was the third
14 most valuable of the issues which depicted here because
15 of its lower yield to maturities principally. Then
16 starting around March 6th, it vaults up to being the
17 least valuable of all of these issues. A remarkable
18 move in spread terms. If you look at it, it's a 10
19 basis point shift, relative -- a 10 basis point
20 relative shift to the on the run issue and the on the
21 run ten-year note at a time when the ten-year yield was
22 only 0.80 percent. So truly an unprecedented move in

1 that relationship.
2 This was a market that was extremely difficult to
3 price sending waves of turmoil through the broader
4 financial markets. And so, if you can flip to slide
5 seven, please.
6 So the early narrative and, you know, we continue
7 to hear echoes of this, including in the presentation
8 earlier today, was that that hedge fund basis traders
9 were engaged in fire sales of Treasuries. But the
10 evidence of this is actually very weak. In fact, the
11 price data in this acute period from March 9th to March
12 13th, shows a very intriguing indication that hedge
13 fund basis traders may have relatively supported the
14 market. So just to level set, and I know this is a
15 highly sophisticated group, but just to level set. A
16 basis trader sells a futures contract and hedges that
17 short futures position with the purchase of cash
18 Treasuries. Buying the Treasury is obviously a cost
19 and naturally any investor will want to do that in the
20 least expensive way. Hence, they purchase the cheapest
21 to deliver bond that is eligible for delivery into the
22 CME futures contract.

1 So when Treasury markets went into disarray, the
2 fascinating thing here to look at is -- and we have not
3 yet seen, you know, consistently explained is that the
4 cheapest to deliver outperformed. It outperformed the
5 rest of the market by a significant basis. A
6 significant margin.
7 So this outperformance is not consistent with the
8 narrative that a basis trading hedge funds were engaged
9 in for sales, because they would have been selling the
10 cheapest to deliver if they had been doing that. So I
11 can also report that we were, as MFA, in constant
12 contact with our members, risk managers and funding
13 desks during that March 2020 period, and particularly
14 that week. And we did not pick up any anecdotal
15 information from our members to suggest that they or
16 their peers were, you know, unwinding or engaging in a
17 disproportionate selling of their basis trading
18 positions.
19 And in fact, in a couple of narrow cases, we
20 understood that there was a liquidity potentially being
21 provided to the market or consideration of raising new
22 funds to provide liquidity to that market.

1 Now, again, March 13th is a significant date.
2 We've spent a lot of time looking very granularly at
3 this because there was some indication that perhaps the
4 reason that the cheapest to deliver without performing
5 was because the Fed began to purchase cheapest to
6 deliver. Normally it does not buy cheapest to deliver
7 securities in its open market operations, it did start
8 doing so on March 13th. And so, I think that can help
9 to explain the outperformance of the cheapest to
10 deliver after March 13th, starting on March 13th and
11 thereafter.
12 But in that period from March 9th to March 13th,
13 it seems that one of the supporters of the cheapest to
14 deliver, one of those giving a demand support to it
15 would have been the hedge fund community.
16 Okay. So we can move to slide eight, please.
17 So, you know, now turning to, you know, some of
18 the structural points about multiple participants in
19 the market. Treasury markets have background dealer
20 capacity. This is data from Darrell Duffie’s paper. I
21 know Darrell will be on the second panel.
22 Part of the reason that Treasury markets rely on a

1 multitude of market participants is that bank's
2 relative capacity to remediate has declined. This
3 chart here depicts the ratio between bank balance
4 sheets and Treasuries in the market. And it clearly
5 shows a drop-off after 2008.
6 If you can move to slide nine, please.
7 So as we said in the beginning Treasury markets do
8 rely on a multitude of market participants. And in
9 fact, now the single biggest participant grouping in
10 both cash and futures markets are the principal trading
11 firms, with banks second, and hedge funds as a distant
12 third.
13 These data are from 2014 from the joint SEC-CFTC
14 Fed-Treasury report. But if anything, Treasury market
15 participation has continued to evolve since then.
16 I would point out that, you know, hedge funds are
17 not an unimportant player, but you know, a relatively
18 small player in the markets.
19 If you can move to slide 10.
20 So, banks do remain the most important source of
21 financing for Treasury positions and collateralized
22 repo is certainly central to this function. And so,

1 here on this slide we want to point out that in mid-
2 March repo pricing became much more tiered. This slide
3 shows the dramatic increase, the dispersion of repo
4 pricing during mid-March.
5 So the largest market participants, including MFA
6 members continued to have good access to repo, but some
7 other market participants clearly must've seen the cost
8 of their financing elevate, as you can see from a kind
9 of -- this is a blow out of 14 times. So the width of
10 the difference between the lowest and the highest repo
11 rates blew out by about 14 times relative to the
12 average.
13 Slide 11, please.
14 Cash balances of basis trading hedge funds is
15 something that, you know, we like to point out is
16 stabilizing, hedge funds that trade the basis know that
17 financing can become scarce as, you know, the prior
18 slide. And as a result, they tend to maintain high
19 cash balances as a prudent measure. On average
20 relative value strategy hedge funds hold about 25
21 percent of their investments in cash as a precaution.
22 Now, if you look at 2020 Q1, you can see sort of

1 43 percent for macro and 26 percent for relative value.
2 These are the strategies that would have been most
3 likely to be are participating in the cash Treasury
4 futures basis trade.
5 And if you look at that, it's hedge funds hitting
6 engaged in massive de-leveraging in March of 2020.
7 What we would have seen here would be changes in the
8 cash balances. In fact, you see a small take-up in the
9 cash balances of three percentage points in each case.
10 It seems, you know, relatively consistent and
11 proportionate with, you know, kind of a prudent
12 building up of cash balances.
13 And so, this leads to then my final point on slide
14 12, which is that Treasury markets on both the cash and
15 the repo side we believe do not yet benefit from enough
16 central clearing choices. Repo financing is really the
17 lubrication that allows the cures of the market to turn
18 into function. And therefore, we feel we should
19 examine potential improvements to it.
20 I would draw your attention to the donut graph on
21 the left, which depicts that two-thirds of repo
22 arrangements are still uncleared. And then on the

1 right hand side, you can see that on the cash market
2 side, only 13 percent of the inner dealer Treasury
3 secondary is centrally cleared and that's far less than
4 in the derivatives markets.
5 In central clearing options, and I think Sam said
6 this very well, facilitate netting and compression
7 which in turn should improve margin efficiency. So
8 more options for central clearing as my colleague, Jen
9 Han will tell you now would really help to modernize
10 Treasury markets and bring them in line with some other
11 parallel markets.
12 And so with that, Jen, I'd like to pass it over to
13 you.
14 MS. HAN: Great. And if we could turn to the next
15 slide, please. Great. Thank you.
16 So for, in working with Michael's Global Markets
17 and Research Group, and our policy committee looked at
18 the data and we've really thought through some of the
19 potential changes and recommendations that could be
20 made.
21 So again, just from the experience of March 2020,
22 also previous events, 2014 Flash rally, just taking

1 into consideration that the Treasury markets have
2 quadrupled in the last 15 years. And again, they're
3 expected to continue growing. So we really think it is
4 important to modernize the market architecture this way
5 to enhance resiliency as well as just to preserve the
6 central role of these markets.
7 So our first recommendation is to expand central
8 clearing solutions. Also, we're very eager to hear
9 from the second panel, but here we think that
10 regulators should work together toward expanding the
11 development of voluntary central clearing and the
12 dealer to customer segment of the Treasury market,
13 before secondary cash market transactions and bilateral
14 U.S. Treasury repos. We think that this will greatly
15 enhance market resiliency. Lead to greater market
16 transparency, greater market liquidity, reduce credit,
17 and operational risks.
18 Also, it will benefit investors by allowing them
19 to net offsetting transactions and have just decreased
20 solvency risk from their counterparties.
21 Our second recommendation is to enhance regulatory
22 data collection. We think that the regulators should

1 work together to enhance the collection to improve the
2 quality of this Treasury data reported through TRACE.
3 So in 2017, FINRA began receiving TRACE Treasury
4 data. And this has proven to be a critical resource
5 for regulators and helping analyze and understand the
6 trading events in Treasury markets. Particularly the
7 most acute stages here of COVID-19. The COVID-19
8 induced market crisis. Also -- well, nevertheless,
9 regulators have consistently asked for enhancements to
10 this data, which MFA very much supports.
11 So first, we think that FINRA should shorten the
12 trade reporting timeframe for Treasuries. Second, we
13 think in FINRA should add a clearing arrangement
14 indicator to create transaction reports, among a number
15 of other enhancements to provide more granular data.
16 And then finally, we think that banking regulators
17 should require that all bank entities that are not
18 FINRA member firms to report Treasury market activities
19 to TRACE. This enhanced reporting will really improve
20 the reliability of data for regulatory purposes and
21 just allow regulators to have a better understanding of
22 trading and market events.

1 Our third recommendation is to introduce public
2 dissemination of post-trade transaction data. So here,
3 we recommend that FINRA works with other policymakers,
4 regulators to gradually introduce post-trade price
5 dissemination of anonymized data on U.S. Treasury
6 secondary market transactions through TRACE.
7 So studies have shown that public price reporting,
8 with appropriate exceptions, has really improved market
9 functioning. And I think that for the CFTC, we have
10 the experience of, for example, the SEF market. So we
11 recommend that regulators consider expanding the
12 dissemination of Treasuries post-trade data through
13 TRACE to be consistent with the transparency available
14 for other markets. Also such as the corporate bond
15 transactions.
16 Again, regulators should take a phased-in
17 approach, calibrate trade size disclosures, and
18 dissemination delays by market segment to protect the
19 anonymity of creating counterparties and to maximize
20 market efficiency and overall market liquidity.
21 So with the introduction of anything again, a
22 steady and calibrated approach, I think we think is the

1 best.

2 Our last recommendation is to rationalize trading
3 venue oversight. We recently -- earlier this year,
4 recommended to the SEC that they extend regulation ATS,
5 the alternative trading systems, that trade government
6 securities or repo or reverse-repo agreements on
7 government securities.

8 So it we're seeing the growth of electronic
9 trading and online trading systems, we think it's
10 really important for investors that regulators ensure
11 the effective regulation of critical market
12 infrastructure and trading venues. Also
13 we want to ensure the robust disclosure and
14 transparency of information to investors about the
15 operations of these infrastructures and venues.

16 Finally, we recommend that the SEC examine other
17 electronic trading venues. So for example, multi-
18 lateral RFQ venues that operate in the government
19 securities markets, and just consider how similarly
20 situated entities might be treated in a more similar
21 manner to improve the efficiency and resiliency of
22 trading in government securities.

1 So that takes us through our slide presentation,
2 and we'll turn back over to Chair Behnam, Commissioner
3 Stump, Andree, and the GMAC.
4 CHAIR KARNA: Thank you Mr. Pedroni and Ms. Han.
5 The floor is now open for questions and comments
6 on all of the presentations of our first panel.
7 Another reminder to GMAC participants. If you
8 could please indicate in using the chat function, if
9 you'd like to make a comment or raise a question.
10 MS. VEDBRAT: This is Supurna from BlackRock.
11 Perhaps I could start if that's okay?
12 CHAIR KARNA: Sure. Go ahead Ms. VedBrat.
13 MS. VEDBRAT: I have you know, actually, a four-
14 part question. You know, one -- you know, we are in
15 favor of central clearing and I think over the last
16 decade seeing the success that we've had with CDS and
17 interest rate swaps, talks to how it helps with the
18 overall resiliency of the market.
19 That being said, as we include more and more
20 products, you know, we would highly recommend that you
21 know, the suggestions that have been made in order to
22 continue to enhance, you know, the overall framework

1 for the clearinghouses, you know, is something that we
2 should consider putting in place as, you know, over the
3 next, you know, several months.
4 The other thing, the second point I want to make
5 is from a, you know, from a collateral standpoint as we
6 have moved products into the central clearing
7 framework, the demand for high quality collateral
8 obviously has also increased. So, you know, what I'd
9 like to be able to consider as we move more and more
10 products, including Treasuries, is you know, perhaps
11 there could be an expansion of acceptable collateral as
12 well as the framework should include the ability for
13 clients to be able to net collateral posted, you know,
14 between various products.
15 And the third, you know, it's actually a question.
16 When we're talking about the clearing solution for
17 Treasuries, you know, if I could just ask, are we
18 talking about both on the run and off the run? Because
19 off the run is, you know, where you know, the market
20 could really benefit from having a more streamlined
21 solution, especially since clearing would also lead to
22 better electronic execution.

1 And then the second, there is in the current -- in
2 the current solution that we have for repo clearing you
3 know, does the end client that is trading using this
4 solution, do they, you know, do they 100 percent face
5 the clearinghouse, or is there still any, you know,
6 linkage with you know, the market participant on the
7 other side, if there were going to be a material
8 negative event in the market?
9 CHAIR KARNA: Thank you, Ms. VedBrat. Would any
10 of our panelists like to address any of Ms. VedBrat’s
11 points before I see if there are any other questions?
12 MR. PEDRONI: Yeah, I would be happy to comment on
13 the first of the two questions on clearing solutions
14 for Treasuries. Just to affirm the point that the
15 market that you know, the benefit or the segment of the
16 market that would benefit significantly from that
17 includes certain off the runs Treasury.
18 So as the speaker pointed out, you know, that is
19 an area where clearing solutions are very slight at the
20 moment. So I just wanted to affirm that that is
21 something where we would [inaudible].
22 CHAIR KARNA: Great, thank you very much.

1 Do any of our other panelists, or do any of our
2 other GMAC participants have any thoughts on what a
3 reform proposals or recommendations whether they were
4 mentioned today or not would best serve the Treasury
5 market to foster resilience and mitigate against future
6 stresses?
7 As reminder if anybody has any comments or
8 questions, please use your WebEx chat function and
9 address your question to all panelists.
10 COMMISSIONER STUMP: Angie, this is Commissioner
11 Stump. I just had a follow-up. I just wanted to make
12 certain that I understood Ms. VedBrat.
13 The conversation you were having, Supurna, your
14 comments relative to the high quality collateral in the
15 event that clearing became more prominent in this
16 space. I just want to make sure, did I understand you
17 to say that there would need to be consideration for
18 expanding the types of collateral that would be
19 eligible?
20 I think that's what you said.
21 MS. VEDBRET: Yes.
22 COMMISSIONER STUMP: Okay. Do you mean, expanding

1 beyond -- would you like to elaborate on the types of
2 collateral you think might be good candidates for the
3 expansion? And if not, that's fine. I just, this is a
4 conversation that we have in our markets as well. So.
5 MS. VEDBRET: So, I would say you know, the idea
6 is obviously that we want to have very liquid, you
7 know, assets that we can use as collateral, you know,
8 beyond what is already acceptable collateral. You
9 know, what, you know, what would come to mind are, you
10 know, if we have very liquid ETFs or, you know, in some
11 cases money market funds that could also be you know,
12 part of the suite of the assets that, you know, can be
13 posted because that would like, you know, avoid in
14 certain situations if clients have to like unwind, you
15 know, these very liquid wrappers in order to be able to
16 post the limited supply of high quality, you know,
17 assets that are currently expected.
18 COMMISSIONER STUMP: Thank you. That’s very
19 helpful.
20 CHAIR KARNA: Thank you Commissioner Stump. Mr.
21 Cutinho, do you have a question?
22 MR. CUTINHO: Yes, thank you. This question is,

1 or comment, is for all the panelists.
2 I think there was -- I don't recall exactly the
3 number of papers, but there were about two papers that
4 were put out on issues with liquidity for broker-
5 dealers in in the securities clearing market. This is
6 because client’s margin cannot be passed on to the CCP
7 to cover client’s activity.
8 Can anybody among our experts speak to that?
9 [No response.]
10 MR. CUTINHO: I can’t believe I left everybody
11 speechless.
12 MS. HAN: I think that question is perhaps better
13 answered by, you know, someone from the broker-dealer
14 community.
15 CHAIR KARNA: Would any other panelists -- would
16 any other GMAC participants like to address Mr.
17 Cutinho's question before we put it aside for a future
18 day?
19 MS. GOLDSMITH: Sunil, this is Andree Goldsmith.
20 I think we have a presenter from our next panel who is
21 absolutely willing to cover your question if you can
22 hold off and wait.

1 MR. CUTINHO: Certainly. This is the first time
2 this has happened to me. Thank you.
3 CHAIR KARNA: Thank you Mr. Cutinho, and thank
4 you, Andree. Mr. Yamada, do you have a question?
5 MR. YAMADA: Yes. I just wanted quickly to ask on
6 the point of transparency, there was a comment around a
7 difference in transparency or liquidity around off the
8 runs versus on the runs and given the difference in
9 holders of those securities, has there been an attempt
10 -- I understand that the Fed and Treasury have spoken
11 to those end-users, but to involve them in this
12 conversation -- it's my view that they would probably
13 be affected by any changes to their -- the information
14 on their trades being disseminated.
15 MR. PEDRONI: Yes, so it's Michael Pedroni. I'm
16 happy to come in on that.
17 I think the primary area where those, you know,
18 foreign official accounts have had a voice so far is in
19 the context of the Financial Stability Board
20 conversations about reforms that should emerge from the
21 Treasury markets.
22 So, you know, that's probably the area where they

1 have the most input with respect to, you know,
2 transparency. The idea is not to -- in post-trade
3 transparency -- the idea is not to divulge the name of
4 the participants, but rather the aggregate anonymized
5 information or the anonymized information on a
6 transaction. So that, you know, users of that data
7 aren't privy to who did the trade, but rather at what
8 price and, you know, in broad brush terms, what
9 quantities.
10 MS. HAN: Right. I agree with Michael's points
11 there. And again, it is why we are advocating for a
12 careful and calibrated approach. And so, to ensure
13 that with respect to any type of price dissemination,
14 there are appropriate caps. And at the, I think, the
15 most important thing is keeping trading anonymous as
16 well as protecting and maximizing the market efficiency
17 and overall market liquidity.
18 So these are all things that need to be
19 considered, you know, when we get to that stage of
20 determining the right calibration.
21 CHAIR KARNA: Great. Thank you, Mr. Yamada, Ms.
22 Han, and Mr. Pedroni.

1 Does anybody else have any questions or comments
2 regarding this at first panel?
3 COMMISSIONER STUMP: This is Commissioner Stump,
4 again. I have a question for Mr. Schulhofer-Wohl. I
5 believe you mentioned in your comments that there could
6 be improvements made to data that's available relative
7 to unclear bilateral transactions.
8 And I just thought I would ask you to expand upon
9 that a little bit. I know we're talking later about
10 our new swaps data reporting rules and the improvements
11 we've made there, but I just thought perhaps it might
12 be worthwhile for this audience to better understand,
13 what do you consider to be missing and lacking with
14 regard to the uncleared bilateral transactions? And if
15 you were referring to the swaps market there or some
16 other element?
17 MR. SCHULHOFER-WOHL: Thank you Commissioner.
18 It's a great question. Unfortunately given our
19 communications blackout rules, and I'm not allowed to
20 answer any questions today, but I'd be very happy to
21 talk with you or others about that question or any
22 other questions after the blackout period.

1 COMMISSIONER STUMP: That's fair enough. Thank
2 you very much.
3 CHAIR KARNA: Thank you, Commissioner Stump.
4 Any other questions for this panel before we move
5 on to our next item on the agenda?
6 [No response.]
7 CHAIR KARNA: All right, great. Andree, we're
8 running a little bit ahead of schedule, but are you
9 aware of whether the second panel is ready to move to
10 go on?
11 MS. GOLDSMITH: I think we're still checking. In
12 the meantime, let me do a couple of attendance updates
13 from people who weren't able to respond on the initial
14 roll call. So on the line in addition to everyone who
15 responded before we have Ted Backer from Morgan
16 Stanley, Paul Hamill from Citadel Securities, Joe
17 Nicosia from Louis Dreyfus, Murray Pozmanter from DTCC,
18 and Maggie Sklar from the Federal Reserve Bank of
19 Chicago, and Jessica Sohl from HC Technologies.
20 I might suggest, while we're just making sure that
21 we have all of our panelists up. That we take maybe a
22 five minute break and reconvene here just before 10:00.

1 CHAIR KARNA: That's perfect. We'll talk to
2 everybody right before 10:00. Thank you.
3 [Break.]
4 CHAIR KARNA: -- move onto the second agenda item
5 for this morning, which is a series of presentations on
6 central clearing and the Treasury market. We will
7 start with a presentation from Professor Darrell
8 Duffie, Adams Distinguished Professor of Management and
9 Professor of Finance at the Graduate School of
10 Business, Stanford University.
11 Please go ahead, Professor Duffie.
12 PROFESSOR DUFFIE: Thank you so much. It's a
13 pleasure to be here. Normally, when I talk about this
14 subject, I would start from base principles, but I
15 think given everyone that's here today, I'll just start
16 with going right into the key issues.
17 I prepared four figures, and if you have those in
18 front of you the first figure is one that should be
19 familiar to most people here. It's an illustration
20 from the General Accounting Office of bid-offer spreads
21 and the off the run and the on the run market leading
22 into and coming out of the March pandemic declaration.

1 And clearly bid-offer spreads widened out
2 dramatically in the inter-dealer market. I want to
3 emphasize what's happening in the dealer-to-customer
4 market, which since we don't have TRACE data for the
5 dealer-to-customer market, or any market for that
6 matter, it's best to look at it in terms of Bloomberg
7 data. And you can see a very dramatic degree to which
8 market participants who are having trouble getting
9 liquidity. And that's evident in many other forms of
10 analysis that probably everyone present has seen a
11 great deal of in the last year.
12 It's sometimes said that when these problems
13 occur, the Fed can come in and fix this situation. And
14 that, while it doesn't happen very often, it's okay to
15 leave it up to the Fed.
16 The diagram shows that it took a number of weeks
17 despite the massive reaction of the Fed, very good
18 reaction. It took a number of weeks before the bid-
19 offer spreads went back to normal and all other
20 indications of market depth and market function also
21 took weeks to recover. So we really can't leave this
22 up to the Fed, purchasers around the world of

1 treasuries were relying on the ability to liquidate
2 their treasuries during a stress period, just like this
3 one. That's why they paid a premium for U.S.
4 Treasuries, so that they would serve as a safe haven.
5 So market structure needs to be addressed and
6 today we're talking about central clearing as a way to
7 address this. Central clearing has a number of
8 benefits, including lowering the commitments of dealers
9 and freeing up space on their balance sheets, and also
10 at least providing a chance for all-to-all trade to
11 relieve dealer balance sheets of some of the need to
12 handle these massive flows during a crisis period.
13 On next slide I show the ratio of treasuries
14 outstanding to total primary dealer assets in the
15 decade before the financial crisis and the 13 years or
16 so since then. And it's pretty obvious from the
17 diagram that dealer balance sheets were keeping up very
18 well with the growth of the Treasury market before the
19 crisis.
20 At that time dealer balance sheets were not
21 heavily constrained by regulation and dealers were
22 getting pretty cheap funding because it was presumed

1 that they were too big to fail. Since then regulators
2 and market participants have learned their lesson and
3 dealer balance sheets have been much more constrained.
4 Meanwhile, the Treasury market has been growing by
5 leaps and bounds. As of 2020, it was around 20
6 trillion. The Congressional Budget Office predicts
7 that by 2050, it will be 120 trillion. So this is one
8 of those trends that's not sustainable. Dealers will
9 not be able to manage stress periods as the Treasury
10 market gets bigger and bigger. On a normal day,
11 everything is fine, but exactly again, when large
12 customers want to liquidate large positions during a
13 very heavy stress period, they won't be getting the
14 safe haven services that they thought that they had
15 paid for.
16 On the next slide -- on the next slide I'm showing
17 broad central clearing affects from analysis by Michael
18 Fleming and Frank Keane at the Federal Reserve Bank of
19 New York. So this is in, some sense, what would happen
20 in a counterfactual world in which all participants
21 centrally cleared. That might be optimistic, but I
22 think you get the picture from the diagram, that the

1 amount of settlement commitments, we go down on peak
2 days from over a trillion dollars last March to the
3 mid-200 to 300 billion range.
4 So a very, very dramatic reduction in dealer
5 commitments to settle.
6 And that's very important, obviously not only
7 because of the regulatory capital requirements, but
8 because of the reason that central clearing came into
9 the market in the first place. Is that it reduces net
10 settlements dramatically and it lowers counterparty
11 risk. It also makes the market more transparent. And
12 it also gives market participants a sense of what
13 margin requirements are broadly in the market.
14 Central clearing is not to be taken for granted.
15 Of course, it must be very well-regulated and I'm sure
16 we'll hear more about that later today.
17 On the last of the four slides that I've prepared,
18 I've put special focus on the implications of
19 settlement failures, which soared dramatically during
20 mid-March. As dealer balance sheets got very clogged
21 up, it was difficult, more and more difficult to finish
22 trades as promised and settlement failures grew to an

1 excess of $500 billion a week in the primary dealer
2 market.
3 FICC sales were somewhat less, my view of this is
4 that because trades at FICC tend to cut off the daisy
5 chain failures by which A fails to B, which then causes
6 B to fail to C and causes C to fail to D, and so on.
7 Fleming and Keane showed that the effect of
8 netting at FICC would have reduced settlement fails in
9 a counterfactual world of broad central clearing by an
10 enormous amount. At least in the most heavily traded
11 securities like the on the runs.
12 I know that we're going to discuss mostly, I hope
13 we will discuss today, mostly the -- how we do this.
14 The DTCC paper, very elegantly says, it's not a
15 question of whether to get broader central clearing,
16 it's how to do it. And I know that we're going to
17 focus on the details.
18 The FIA paper put together by principal trading
19 firms provides a lot of clues about how to do that.
20 I hope we will zero in on the recommendations in that
21 report. And Laura Klimpel today, I believe, will help
22 us understand where the impediments might be and how

1 FICC can help with this. So I'm in listening mode when
2 they speak, I want to learn from both of them how to
3 remove some of the roadblocks.
4 Their work suggests that there are avenues by
5 which a lot more could be done without going to a very
6 heavy regulatory mandate. And if a mandate is needed
7 and it may well be, they also provide clues as to how
8 to do this without causing undue costs or even possibly
9 worsening the performance of the market for certain
10 segments of market participants.
11 So with that, I'll turn it back to our hosts.
12 Thank you very much.
13 CHAIR KARNA: Thank you very much, Professor
14 Duffie. The second presentation will be from Graham
15 Harper, Executive Committee Member of the FIA Principal
16 Traders Group, and Head of Public Policy and Market
17 Structure at DRW Trading Group. Please go ahead, Mr.
18 Harper.
19 MR. HARPER: Thank you, Angie. And good morning
20 Commissioner Stump and Chairman Behnam, Commission
21 staff and GMAC members. On behalf of the FIA Principal
22 Traders Group, I appreciate the opportunity to present

1 our July white paper on Treasury clearing here today in
2 front of the GMAC.
3 The FIA Principal Traders Group is an association
4 of firms that trade their own capital on exchanges in
5 futures options and equity markets worldwide. Many of
6 our members are active participants in both the cash,
7 Treasury, and repo markets, particularly in electronic
8 IDB markets.
9 Ongoing regulatory discussions related to the lack
10 of growth in central clearing and Treasury, cash and
11 repo transactions, including possible clearing mandates
12 prompted us to highlight what we believe to be
13 obstacles to voluntary clearing and issues that would
14 certainly need to be resolved prior to any mandates
15 being implemented.
16 If we could move sort of past the table of
17 contents here.
18 We're supportive of the ongoing efforts to
19 increase central clearing and Treasury markets based on
20 the many benefits we believe clearing brings to
21 markets, namely improvements to market resiliency, to
22 market liquidity, and market transparency as noted on

1 slide three.
2 We've consistently advocated for the importance of
3 central clearing and other asset classes, including
4 swap reforms undertaken by the CFTC in accordance with
5 Dodd-Frank.
6 And there are some lessons we feel are helpful
7 from that experience, which I'll touch on a bit later.
8 As noted on slide four, currently uncleared cash
9 Treasury transactions account for more than 75 percent
10 of the secondary market, and uncleared bilateral repo
11 account for approximately 50 percent of the U.S. repo
12 market. And the vast majority of Treasury clearing at
13 FICC is done by direct members not through client
14 clearing.
15 Of the greatest importance in our view to increase
16 central clearing is a need for a client query model
17 that all market participants can access and utilize.
18 And irrespective of asset class, most market
19 participants, including buy side investors and many
20 PTFs access central clearing through a client clearing
21 model for a variety of reasons, which are laid out in
22 the following slide.

1 It's critical for a viable client clearing model
2 to exist in order to provide true access to large
3 swaths of the market.
4 We appreciate the efforts that the FICC has
5 continued to make to its current client clearing
6 offerings, but we still see issues that warrant
7 attention, a brief description of each of those
8 offerings and their distinct limitations are shown on
9 slide six and seven.
10 And the issues we identify in the white paper none
11 are more important than the current ability of clearing
12 members and the sponsor model to discriminate based on
13 execution counterparty. What are referred to as quote,
14 "done with trades," where the sponsor has the ability
15 and in practice does only accept transactions that are
16 executed with them.
17 The FICC-sponsored clearing offering could provide
18 market participants with a viable client clearing
19 solution if clearing members were not permitted to
20 discriminate based on execution counterparty.
21 And I'd point out, particularly given the audience
22 today at the CFTC, that similar issues were raised by

1 market participants and ultimately addressed in the
2 CFTC swap-related rulemakings during the implementation
3 of Dodd-Frank. CFTC rules prohibit any arrangement
4 that discloses the identity of a client execution
5 counterparty to its clearing number or otherwise limits
6 the number of counterparties with whom may client may
7 trade.
8 In addition, in order to further facilitate client
9 access to clearing, the CFTC requires clearing members
10 to comply with detailed conflicts of interest
11 requirements, including operating independently from
12 affiliated trading businesses. These steps have
13 successfully expanded client access to clearing and
14 CFTC-regulated products.
15 Sorry. I forgot to skip the slide and add to
16 point out my power went down right before this started.
17 So if you hear a generator humming in the background,
18 I'm not cutting the grass.
19 So if we could skip forward on the slides. Yeah,
20 thank you.
21 We recommend that FICC in coordination with
22 relevant regulators implement similar enhancements to

1 its client clearing offering, so that it's available to
2 all types of market participants.
3 In particular, we think FICC should remove the
4 ability for sponsor clearing members to discriminate
5 based on execution counterparty, require clearing
6 members to operate independently from the affiliated
7 trading businesses when deciding whether to offer
8 clearing services to a particular client and the
9 associated commercial terms, and then in addition, the
10 FICC and CME should permit both direct clearing members
11 and clients to utilize cross-margining arrangements on
12 fair and non-discriminatory terms, which we also
13 acknowledged would require some regulatory intervention
14 as well.
15 And finally, FICC, should ensure clients are
16 adequately represented in CCP governance processes,
17 including the risk committees and the working groups
18 involved in determining the rules and design of the
19 client clearing model.
20 We look forward to continuing working with FICC,
21 the clearing member community, and the various
22 regulators to continue to move towards truly viable

1 client clearing model for Treasury markets. And again,
2 I thank the CFTC and the GMAC the ability to add our
3 voice to this important discussion.
4 CHAIR KARNA: Thank you, Mr. Harper. The third
5 presentation will be from Laura Klimpel, General
6 Manager at Fixed Income Clearing Corporation.
7 Please go ahead, Ms. Klimpel.
8 MS. KLIMPEL: Thanks very much to Chair Behnam,
9 Commissioner Stump, and the Global Markets Advisory
10 Committee for having me here today.
11 In terms of describing what the benefits could be
12 derived from increasing central clearing in the U.S.
13 Treasury market, I feel the panelist has done a great
14 job of covering the waterfront of benefits. However,
15 the only other benefit I would add to the list is
16 mitigation of fire sale risk, which I would argue
17 should be one of the top priorities for the official
18 sector when thinking about how to make the Treasury
19 market more resilient to withstand future stresses.
20 Specifically, what I mean is that essential
21 counterparty is uniquely positioned through its ability
22 to centralize and consolidate the liquidation of a

1 defaulted market participant in a manner that minimizes
2 risk of loss and the risk of market disruption that
3 cannot be avoided if individual bilateral
4 counterparties are required to each act on their own
5 outside of central clearing to liquidate the defaulters
6 collateral.
7 In terms of accessing central clearing, we
8 wholeheartedly agree with the PTG that we require
9 viable client clearing models, by which market
10 participants that either can't for regulatory or other
11 reasons become a direct member of FICC or who choose
12 not to, because it does not align with their business
13 model, have means to access central clearing and that
14 having client clearing models for this reason is
15 critical. Especially if we are considering expanding
16 the amount of Treasury activity that FICC clears.
17 That said what the prior presentation
18 characterized as material limitations in six various
19 client clearing models. We would characterize as
20 options. Each of each of which has important use cases
21 that are necessary to support access to clearing for
22 the diverse array of market participants in the U.S.

1 Treasury market and the varying types of Treasury
2 activity they clear at FICC.
3 I'd like to first start with FICC’s correspondent
4 clearer model and prime brokerage model.
5 The PTG is correct as they depict in their slides
6 and as we note in our most recent white paper that has
7 been submitted for the Committee's consideration. In
8 those models, the underlying client does not become a
9 member of FICC. And as such, FICC in neither of those
10 models has direct obligations to them only to the
11 correspondent clearer or the prime broker itself. This
12 allows FICC to net the margin associated with the
13 activity in the core clearers or prime brokers account,
14 including across clients, which in most cases will
15 result in a reduction of margin costs for the clearing
16 intermediary.
17 This type of margin efficiency may be very
18 valuable to a given client and it's clearing
19 intermediary in terms of reducing the clearing costs,
20 especially in cases where the primary motivation for
21 participating in central clearing is to take advantage
22 of FICC’s multi-lateral net settlement process to make

1 the settlement of their Treasury transactions more
2 operationally efficient than it would be outside of
3 central clearing.
4 This is the point Darrell was making earlier.
5 Rather than for example, the benefits of novation
6 to and credit intermediation by FICC. If market
7 participants and their clearing intermediaries value
8 that more, they might elect for the sponsored clearing
9 model instead, and to BlackRock's question in the
10 sponsored model, there is a true novation of the market
11 participants, i.e. BlackRock's positions to FICC and
12 the market participants as the sponsored member would
13 have direct obligations to FICC and FICC would have
14 direct obligations to it, including guarantee of
15 performance on its activity.
16 The prior presentation also noted that minimal
17 repo is flowing through the correspondent clearing and
18 prime brokerage clearing models today. We'd agree that
19 statement of the 80-plus billion we see flowing through
20 those models daily, the majority of that activity is
21 Treasury cash activity.
22 We believe this to be the case because as we

1 discussed in our white paper, these two models have
2 been designed and primarily used for agented style
3 clearing, akin to the FCM model in the derivative
4 space, with respect to Treasury cash transactions. The
5 accounting analysis necessary to be comfortable acting
6 as an agent clearer for repo is something that most
7 dealers have yet to do, largely because it hasn't been
8 necessary because they could just keep that activity
9 outside of central clearing.
10 With that said, this dynamic is beginning to
11 change as we work with more agent clearers to bring
12 their client activity into FICC. And the accounting
13 work, previously done by FCMs, get comfortable acting
14 as agent clearers in the derivative space has been very
15 helpful in this regard.
16 Switching gears to discuss sponsored clearing the
17 PTG note that FICC does permit transactions of a
18 sponsored member client to be executed either with the
19 sponsoring member itself or with a third-party. This
20 allows sponsored activity to be executed both on an
21 anonymous intra-dealer broker platform, akin to
22 exchange trading in the derivative space or

1 bilaterally.

2 FICC believes it is essential to its ability to
3 fulfill its obligation to provide fair and open access
4 to central clearing that it retain all of the client
5 clearing models that it currently has as the array of
6 market participants in the Treasury market is very
7 diverse, such that a singular model for client clearing
8 will not work and will actually have the adverse
9 consequence of disenfranchising many market
10 participants from clearing.

11 As an example, money market funds regulated by the
12 SEC, under the Investment Company Act of 1940,
13 including SEC rule 2a-7, are critical liquidity
14 providers to the Treasury market. These funds do not
15 typically participate in the derivatives markets and
16 are not capable from either a regulatory or an
17 operational standpoint to participate in an agented
18 style, give up client clearing arrangements like the
19 FCM model, where the agent clearer would look to charge
20 back all of the costs of clearing, including margin,
21 liquidity, loss mutualization, and fees to the client.

22 2a-7 funds are not permitted regulatorily and are

1 not operationally set up to absorb those types of
2 chargebacks. The only practical means they have to
3 compensate their clearing intermediary is through a
4 spread on the activity, which allows the clearing
5 intermediary to absorb the costs of clearing for them.
6 And there are other types of regulated buy-side
7 firms in the Treasury market that are similarly
8 situated.
9 In order to avoid disenfranchising those
10 communities from having access to central clearing,
11 FICC believes it is essential to have client clearing
12 models that allow for principle trading between clients
13 and clearing intermediaries, such that the client can
14 pay the intermediary a spread on its cleared activity
15 to compensate the intermediary for the cost of
16 clearing.
17 The counter concern articulated by the PTG is that
18 because FICC permits clients to trade principle
19 with their clearing intermediaries and clearing means
20 that intermediaries will be reluctant or unwilling to
21 provide them with agented style clearing services at
22 FICC.

1 To pressure test this concern, FICC has
2 proactively reached out to FCMs that provide agented
3 clearing services to PTFs in the derivative space and
4 inquired as to whether they would be interested in
5 extending their offerings to Treasury clearing through
6 FICC. We have been met with great enthusiasm by those
7 firms and are actively working with them to roll out
8 agented style clearing offerings at FICC.
9 So we believe that partnerships between like-
10 minded clients and clearing intermediaries are viable,
11 notwithstanding the fact that FICC offers other styles
12 of client clearing to service other communities that
13 are differently situated.
14 That being said, there is definitely still more
15 work to do to ensure the viability of increasing client
16 clearing at FICC in connection with a potential
17 Treasury clearing mandate. And some of those items
18 will require public-private partnership to resolve.
19 First, and I believe prior panelists have touched
20 on this. We need to improve the efficiency of cross-
21 margining between cash and derivatives. Namely the
22 FICC-CME cross-margining arrangement. The current

1 cross-margining arrangement is being actively worked on
2 to enhance cross-margining efficiency. And we hope to
3 roll out an enhanced model by June 2022, subject to
4 regulatory approval, of course.
5 One of those approvals will need to be from the
6 Commission.
7 That current arrangement only covers the
8 proprietary positions of common FICC-CME members. A
9 cross-margining arrangement covering positions held by
10 customers, as between FICC and CME, has never been
11 approved. And we look forward to working with CME, the
12 Commission, the industry, the SEC, the Fed, and others
13 to make customer level cross-margining a reality.
14 And of course, when we receive approval for that
15 type of arrangement, our rule book will be revised
16 accordingly.
17 The next point I want to raise, and this was
18 something that Sunil pointed out earlier, another area
19 where public-private partnership will be required to
20 improve the efficiency of client clearing at FICC
21 relates to the treatment of margins posted by a client
22 to a clearing intermediary for FICC activity.

1 Unlike in the derivative space where it is
2 commonplace for FCMs to rehypothecate margins pledged
3 by clients to them onward to the DCO. And there is no
4 penalty to the FCM for doing so. A clearing
5 intermediary at FICC is not permitted to rehypothecate
6 client margin without reserving commensurate funds
7 according to the reserve calculation prescribed by SEC
8 Rule 15c3-3.
9 What this does is it effectively requires clearing
10 intermediaries to use their own funds to cover margins
11 that FICC would make, which makes it very challenging,
12 especially for agents and clearers to offer client
13 clearing of treasuries at scale through FICC.
14 We look forward to working with the broker-dealer
15 community and the SEC to operationalize the type of
16 relief required to allow broker-dealers to
17 rehypothecate margins received from clients to FICC,
18 similar to the type of relief that Options Clearing
19 Corporation has obtained in the past.
20 And the last area, I want to point out where there
21 is still work to do, relates to FICC offering locked-in
22 style trading and clearing relationships for the PTFs

1 and their clearing intermediaries.
2 In other spaces, FICC offers the ability of
3 clients and their clearing intermediaries to establish
4 locked-in trading relationships, such that all trades
5 executed by a client are sent directly to the CCP
6 locked-in without a need for matching at the individual
7 transaction level.
8 We have a similar construct in the equities
9 clearing market.
10 We want to work with the PTFs and their clearing
11 intermediaries to put that style of locked-in trading
12 and clearing in place for them, as we believe it would
13 best suited for their business arrangements and trading
14 practices.
15 So with that, I will stop there and ask if there
16 are any questions or otherwise yield back to our host.
17 CHAIR KARNA: Thank you very much, Ms. Klimpel.
18 The floor is now open for questions and comments
19 on our presentations in panel two. As a reminder, if
20 you have any question or comments, please use the WebEx
21 chat feature on the bottom right of your screen, and
22 send a message to all panelists.

1 While we're waiting for people to gather their
2 thoughts, Mr. Cutinho, you had a question raised
3 earlier. I know that Ms. Klimpel touched on it. Do
4 you want to ask it again or was it answered?
5 MR. CUTINHO: No, I think Laura did a wonderful
6 job answering that. I think it's important to
7 understand that the structure for clearing in the
8 treasuries world needs to change for it to be accepted
9 broadly.
10 So, I think Laura covered it. You know, a lot of
11 the clients cannot be direct members. That's true.
12 And to support a broad base of intermediaries who can
13 provide clearing access, it's important to make it
14 capital efficient. So, and also from a risk
15 perspective, we need to remove the liquidity risk
16 pressure.
17 So what Laura points out is actually the source of
18 liquidity stress in the securities market. Early this
19 year, we saw that through meme stocks. So if we don't
20 put in place those reforms, I think you cannot expand
21 clearing to a broad base of clients coming through
22 intermediaries.

1 So I thank Laura for actually raising that.
2 And the second piece, I think Laura is right.
3 Cross margining is very important. In many cases, it's
4 a prerequisite, you know, unfortunately it's limited to
5 only direct members. The ideal cross-margining program
6 is the one we have at the Options Clearing Corp. So
7 putting in place such a cross-margining program will
8 only enhance the incentives for clearing. Otherwise
9 there are lot of constraints to actually grow clearing
10 access.
11 CHAIR KARNA: Thank you, Mr. Cutinho.
12 A question for all of our GMAC participants and
13 panelists, we've heard a lot about the benefits,
14 potential benefits to increase clearing of treasuries.
15 Does anyone have any views on any challenges or
16 impediments that should be considered in order to
17 increase central clearing, beyond what has already been
18 raised or perhaps to emphasize some of the points that
19 have been raised by some of our panelists?
20 MS. VEDBRET: I would like to -- this is Supurna
21 from BlackRock. You know, I would just like to ask a
22 clarity question. You know, at the back of the

1 question I had ask after the previous panel.
2 CHAIR KARNA: Please go ahead, Ms. VedBret.
3 MS. VEDBRET: Well, thank you for the information
4 on explaining how clients like, you know, BlackRock you
5 know, would novate the trades to FICC. My, you know,
6 my follow on question, and this is, you know, purely
7 for clarity sake, if you could help me understand.
8 When the trades are novated to FICC, you know,
9 does the original, you know, counterparty have any
10 residual risk, you know, to one another as the original
11 executing counterparties, especially, you know, in the
12 event of a default, because today when we clear swaps,
13 you know, that link with -- you know, with the original
14 executing counterparty is completely broken. We are
15 100 percent facing, you know, the clearinghouse whether
16 it’s CME, LCH, ICE, what have you.
17 So if you could just help me understand that piece
18 because that's very critical to the way we would look
19 at, you know, the risk to the clearinghouse itself as
20 we move into this model.
21 MS. KLIMPEL: I'm happy to take that. This is
22 Laura. So thanks for the questions Supurna.

1 So in what I alluded to in my prior remarks, when
2 we're talking about sponsored clearing, a BlackRock
3 fund would become a direct limited member of FICC and
4 there are many BlackRock funds that are participating
5 in repo clearing through FICC today.
6 So when that happens and when the transaction is
7 novated to FICC, FICC will become through the novation
8 process, the obligor to BlackRock on that transaction,
9 such that if there is a default of the intermediary or
10 any other member of FICC, FICC is obligated to perform
11 to BlackRock under its CCP guaranty.
12 Now in terms of whether there is still a
13 relationship maintained between BlackRock and whoever
14 it chooses to use as its clearing intermediary. The
15 answer is yes, in two ways.
16 Number one, the clearing intermediary retains the
17 responsibility to act as BlackRock's processing agent
18 for all transactions, submissions, settlements, et
19 cetera, to the CCP. They continue to be the pipes and
20 plumbing of BlackRock to the CCP.
21 And number two, they retain a responsibility to
22 FICC to be a guarantor of your performance to us. So

1 that they retain a processing agent responsibility and
2 a guarantor responsibility post-novation but FICC will
3 have separate obligations to BlackRock to perform on
4 its transactions. And that's why in the sponsored
5 model, as we talk about in our paper, that product is
6 gross margined such that we hold individual VaR base
7 margin for each underlying sponsored members, such that
8 we can guarantee performance to them separately.
9 I hope that answers your question.
10 MS. VEDBRET: Yes. Thank you. Because it's this
11 linkage in answer to your question, I think the
12 scalability, you know, of adding funds or accounts to
13 the model, you know, maybe a little bit cumbersome
14 because we would have to keep in mind what is, you
15 know, the counterparty exposure beyond just the
16 clearinghouse.
17 So that's just something to point out. That we
18 don't have that issue in the swap clearing model.
19 MS. KLIMPEL: So I guess I would point out, you
20 know, the other option. Would be to come in as a
21 direct participant, you'd need to have a regulated
22 entity in order to become a direct member of FICC. So

1 that's also an option in which case you wouldn't need
2 to be relying on an intermediary at all and would avoid
3 that possible linkage.
4 But I would just note that there are other ways to
5 mitigate the type of what I would call settlement agent
6 risk that otherwise is necessary in this type of a
7 structure, and that would be through diversification of
8 intermediaries. We have -- most of our major asset
9 managers in the product have, you know, at least two
10 upwards of 10 or more sponsoring members in the
11 product. So that's another means by which to mitigate
12 that risk.
13 MS. VEDBRET: Thank you.
14 CHAIR KARNA: Thank you both. Professor Duffie, I
15 believe you may have a question. Could you please go
16 ahead?
17 PROFESSOR DUFFIE: Yes. I have a question about
18 the FIA paper’s suggestion that it's problematic when
19 one's clearing member is also one’s dealer. What would
20 prevent a PTF from clearing through a member, an
21 existing member of the FICC that's also not active as a
22 dealer, like a large custody bank? Say Bank of New

1 York-Mellon or State Street?

2 Might this avoid the conflict of interest that's

3 mentioned in the FIA paper?

4 MR. HARPER: Professor it certainly could. I

5 mean, the current issue is that there just aren't

6 sponsors offering the services that most of our members

7 are looking for.

8 Be that clearing cash for the most part generally,

9 or any sort of portfolio clearing, which is, you know,

10 where the predominant amount of the transactions

11 occurring through IDB venues. But the portfolio

12 approach is just something that I think most people

13 need rather than just one-off trades being cleared.

14 So to Laura's point, the rule book does allow for

15 that. The problem is commercially that option doesn't

16 really seem to be available.

17 PROFESSOR DUFFIE: That's interesting because one

18 would think a firm like Bank of New York-Mellon has all

19 of the necessary capabilities; technically,

20 operationally, and would find this an interesting

21 business opportunity as well.

22 MR. CUTINHO: But Darrell, they have to finance

1 the margin and the clearinghouse.

2 PROFESSOR DUFFIE: Everyone wants -- I just wanted
3 to say, I noticed a thread throughout the discussion in
4 the papers is that there are fees and cost that lie in
5 the --

6 MR. CUTINHO: Yeah.

7 PROFESSOR DUFFIE: -- way of all this happening.
8 And yet nobody wants to pay to protect everybody else
9 in the market from themselves. And yet there is a need
10 to do that. It's a common good when people are forced
11 to pay fees that protect everyone from everyone else.

12 So I don't expect voluntarily people will pay
13 fees.

14 MR. CUTINHO: No, but there is a cost. The cost
15 threshold is too high. So in a futures world, that's
16 what happens, you know, there are a lot of clearing
17 members that provide clearing services that are not
18 participants in the market. They just clear -- they're
19 not liquidity providers in the market. They just
20 clear. They cannot -- I mean, that option is not
21 accessible.

22 And then second thing is there is a liquidity cost

1 to actually supporting clients.
2 CHAIR KARNA: Ms. Klimpel, did you want to add
3 onto this?
4 MS. KLIMPEL: I did. Yeah. I just wanted to
5 point out that, you know, further to Sunil's point and
6 in my prior remarks, I think most likely the more --
7 the road to go down that's probably going to be more
8 fruitful is in bringing intermediaries that have
9 business models where they are built to do agented
10 clearing like FCMs to have them translate that offering
11 into the Treasury clearing space, because they're
12 already comfortable, you know, not serving as execution
13 counterparties, but just providing clearing services.
14 They're comfortable doing it in derivative space for
15 PTFs.
16 And now the work is to translate that those types
17 of offerings now to the Treasury cash market.
18 And that's where the issue around rehypothecation
19 of margin and making sure that that is not penalized
20 under SEC regulations, is key because those FCMs that
21 are used to providing the service in the derivative
22 space has not had that friction previously. It's a

1 unique regulation to the cash market that needs to be
2 addressed in order to ensure that the economics can be
3 equivalent as between the agents of clearing services
4 they offer in derivatives versus in the cash market.
5 PROFESSOR DUFFIE: This is a 15c3 point in your
6 papers. Is that right Laura?
7 MS. KLIMPEL: Yes, Darrell. Correct.
8 PROFESSOR DUFFIE: And has the SEC been made aware
9 that this is an impediment and are there any advantages
10 to the existing 15c3 rules or is this simply an obvious
11 thing that needs to be done, but hasn't been done yet?
12 MS. KLIMPEL: I mean, I think to answer your
13 question, certainly we've discussed it with them.
14 I would argue that the issue has not really come
15 to a crescendo until now, because as I noted in my
16 prior remarks, agented type activity in a lot of cases
17 happens outside of central clearing, Darrell, because
18 there isn't a clearing mandate.
19 So now as people look to bring more and more
20 activity into central clearing for a host of different
21 reasons, including agented style clearers, that's where
22 this issue really comes to a head and it has to be

1 addressed. And I would say this is both for firms that
2 are used to trading or used to transacting as FCMs in
3 the derivative space, as well as prime brokerage
4 activity.
5 Figuring out how to make sure that that's
6 economical, I think, requires a look at c3 and relief,
7 similar to what OCC has gotten in the past.
8 PROFESSOR DUFFIE: Thank you.
9 Well, just as a follow-up let's suppose that that
10 pathway were cleared, would clearing members that are
11 dealers then have sufficient incentive to provide this
12 clearing service without requiring the -- well, without
13 running into the impediments mentioned in the FIA paper
14 about combining clearing and counterparty trading? Or
15 would there remain a conflict of interest?
16 MS. KLIMPEL: I mean, just speaking for FICC, I
17 think that it certainly, isn't going to be in every
18 dealer's business model to offer agency clearing
19 services. But there, but there are some, and those are
20 the ones that we are working with. Right? To make
21 sure that -- and they've expressed that they want to
22 offer this service to their clients, including to the

1 PTF clients. But one of the roadblocks that needs to
2 be addressed in order for them to -- for it to make
3 economic sense for them to offer this service at scale,
4 is the c3 relief.
5 So I think it's more about enabling people who
6 have agented clearing models to leverage that model in
7 the U.S. Treasury market. You know, I think that's
8 probably the most productive path to go down.
9 MS. VEDBRET: I think also the ability to have
10 cross-margins --
11 MS. KLIMPEL: Yes.
12 MS. VEDBRET: You know, will help because at the
13 end of the day, you know, clearing is a volume game.
14 You know, still being able to reduce the collateral
15 costs as well as -- I mean, the amount of collateral
16 you post and you know, your capital against the trades
17 can both can benefit if they are allowed to have the
18 ability to offer cross-margining.
19 CHAIR KARNA: Thank you, Ms. Klimpel and Ms.
20 VedBret. Professor Duffie, did you have any other
21 questions?
22 PROFESSOR DUFFIE: Well, I don't want to

1 monopolize the questions, but I did have one about the
2 pending business of market access, which is suggesting
3 it's going to provide all-to-all trading services.
4 I don't I don't see the -- well, I'd like to hear
5 more about the scenario by which once that business
6 builds up to a sufficient scale, it can be centrally
7 cleared. I imagine that market access won't have the
8 necessary balance sheet to centrally clear it on its
9 own.
10 MS. KLIMPEL: I'm happy to speak to that unless
11 there are others.
12 CHAIR KARNA: Please go ahead, Ms. Klimpel.
13 MS. KLIMPEL: Sure. So yeah, Darrell, I agree
14 that that central clearing definitely enables all-to-
15 all trading and it certainly -- it certainly has
16 historically in terms of, you know, intra-dealer broker
17 activity or at least part of it that whereby in the
18 case of repo all IDB trading comes through the CCP
19 because all participants in that market are either
20 members of FICC or clients of a member of FICC.
21 So I think that definitely, you know, all-to-all
22 trading and clearing go hand-in-hand. And certainly

1 the more intermediaries that we have in central
2 clearing, including, you know, agented clearers who are
3 willing to, you know, offer a business where their
4 clients are allowed to execute on all-to-all platforms
5 and they effectively, you know, wear the risk of that
6 activity to the CCP.
7 I think that central clearing can go a long way to
8 growing those markets.
9 PROFESSOR DUFFIE: So agented clearing model would
10 be the model for a trade platform of this type?
11 MS. KLIMPEL: It would have to be, right?
12 Because, you know, the other types of client
13 clearing that we offer are where the trading
14 counterparties are the client and the clearing member.
15 Which is -- in my prior remarks, I talked about is
16 essential for some of our more regulated buy-sides that
17 can't otherwise participated in agented style clearing
18 model, where they would have to be charged back all the
19 costs.
20 But for those clients and their intermediaries
21 that, you know, are looking to do an agented style
22 client clearing arrangements, then yes, that's where I

1 would see all-to-all fitting in, as well as for direct
2 members of the CCP.
3 PROFESSOR DUFFIE: Thank you.
4 CHAIR KARNA: Ms. VedBret, did you want to add
5 anything to that?
6 MS. VEDBRET: I was just going to, you know,
7 suggest that we think about the execution platform, you
8 know, separate from, you know, the clearance. You
9 can't have electronic trading without clearance, and
10 then, you know, the electronic platforms, even today,
11 if you look at some of the other products that you
12 know, that we centrally clear. The products can
13 execute on their platforms and then they go to the
14 clearinghouses to be cleared.
15 So, you know, the question on market access -- you
16 know, what market access does is it does allow you to
17 have -- to choose who your counterparty is. And in the
18 event that you don't want to like, you know, in the
19 all-to-all trading, their broker-dealer would step in
20 the middle.
21 So I think it's, you know, progressive. Where we
22 can end up, you know, linking the execution of

1 treasuries with whenever the clearing model is you
2 know, ready for large scale clearance without, you
3 know, too much work on the electronic trading
4 platform’s part.
5 We've done it in the past and even if you don't
6 get the models today, you know, they work pretty well.
7 CHAIR KARNA: Thank you Ms. VedBret.
8 Does anyone else have any questions or comments
9 for our panelist?
10 MS. HONG: Hi, it's Amy Hong at Goldman Sachs.
11 CHAIR KARNA: Hi, Ms. Hong, please go ahead.
12 MS. HONG: Hi. I just wanted to take a step back.
13 As the panelists have cited central clearing can
14 deliver important benefits to markets including
15 operational efficiencies, reduced risks, enhanced
16 transparency and data supports that broad-based central
17 clearing would have reduced counterparty risk in the
18 system.
19 But it's not apparent that it would have created
20 incremental risk capacity nor relieved the supply
21 imbalance that was a key issue in Spring of 2020. As
22 you know, even with netting the market was heavily one

1 directional.

2 I’d appreciate the panelists and other committee
3 members’ suggestions on how to evaluate whether broad-
4 based clearing would have relieved the market stress we
5 witnessed, particularly for off the run treasuries.

6 PROFESSOR DUFFIE: Well, this is Darrell. I'll
7 take a first shot at that one. Just a moment ago. We
8 discussed the possibility of an all-to-all trading
9 venue that doesn't require use of dealer balance
10 sheets. Dealer balance sheets, where the scarce
11 resource last March. It wasn't simply that it was a
12 one-sided market.

13 It was also the fact that all of those trades had
14 to go across from a customer side, had to go across the
15 dealer balance sheet, and basically clogged up those
16 balance sheets so badly that the dealers were not
17 interested in taking more trades except at a very large
18 bid offer spread.

19 And that's fair game for them. They made a lot of
20 money last Spring but their balance sheets where the
21 constraining element of the market structure.

22 If central clearing were more broadly available, a

1 lot of trades would bypass dealer balance sheets, a
2 buyer, an ultimate buyer say a hedge fund could sell to
3 an ultimate -- that could buy from an ultimate seller
4 like an insurance company or a foreign central bank on
5 an all-to-all platform.
6 So that's in one respect. There's another
7 respect, which is that when trades fail to settle, they
8 start to add to the dealer capital commitments and
9 settlement failures were rampant last March in the
10 hundreds of billions of dollars a week. That would
11 have also -- central clearing would have reduced those
12 settlement failures dramatically and also freed up a
13 lot of dealer balance sheets.
14 So that's two examples by which central clearing
15 might have made more space available on dealer balance
16 sheets. There are other opportunities, but I don't
17 want to monopolize the answers to this question.
18 Maybe my colleagues on the panel might have other
19 points to make.
20 MR. CUTINHO: No, but Darrell aren’t you assuming
21 that then there is a large selling pressure that there
22 is a buyer on the other end, because the dealer is an

1 intermediary.
2 So there are two choices, right? They either
3 warehouse it and they sell it eventually to the
4 ultimate buyer or they have a buyer ready to buy and
5 the problem is a transient one.
6 I think that's where Amy is coming from. Now I
7 don't know the entire dynamics that well. Are we sure
8 that during the Spring of 2020, that there was a buyer
9 there to absorb all that selling?
10 That's the question I think.
11 PROFESSOR DUFFIE: Okay, let me address that one
12 head on, because I have heard that there were only
13 sellers and no buyers. In the equities market there
14 were a huge amount of sellers. The price dropped
15 dramatically to the point at which buyers came into the
16 market. In the treasuries market that could not happen
17 because the dealer balance sheets were constrained.
18 In a market as broad as the U.S. Treasuries
19 market, there will always be buyers if the price gets
20 small enough. Of course, the concern is that prices
21 will have to drop to clear the market, but that's a
22 normal state of affairs in a crisis. Sometimes

1 treasuries appreciate in market value in a crisis
2 because they're a safe haven.
3 Last March, because it was very difficult to use
4 the treasuries market. The treasuries were not viewed
5 as a safe haven. So I think there's a kind of self-
6 fulfilling aspect of everyone wanting to sell and few
7 being able to buy because dealers were constrained and
8 the degree to which they were willing to intermediate
9 at no bid-offer spreads.
10 Markets tend to function when you let them and
11 markets do tend to clear when market structure is able
12 to match buyers and sellers quickly enough.
13 MS. KLIMPEL: I'd like to jump in this if you
14 don’t mind. This is Laura.
15 So I agree with almost everything that has been
16 said. And there's definitely, when it comes to central
17 clearing, there is some balance sheet and capital
18 constraints that central clearing can help alleviate
19 and some that it can't particularly when dealers have
20 to increase the amount of inventory there that they're
21 holding.
22 But I think the important point in, and where

1 central clearing becomes really, really important is at
2 these times when there is a supply demand mismatch,
3 where we see the market under stress, what central
4 clearing does very well is it protects the system in
5 the event that that type of a stress should create, you
6 know, circumstances such that one or more market
7 participants defaults. Right?
8 So it's the downward spiral of the stress causing
9 members to default, which is where the clearinghouse
10 can come in and stabilize the situation by mitigating
11 fire sale risk, doing liquidations in an orderly
12 fashion and otherwise stabilizing the market.
13 So I think -- can central clearing solve for all
14 types of rate volatility and stress?
15 No, but the idea is that it can provide the system
16 with more resiliency to absorb those types of stresses
17 and potential defaults that come there from.
18 MR. NICOSIA: This is Joe Nicosia with Louis
19 Dreyfus. Question. Have you given any thought of the
20 size of the capital that is necessary in order to
21 perform the clearing function? Because as we've seen
22 in past years, stress in the clearing function in of

1 itself can be more devastating than stress within the
2 marketplace.
3 And so, in order to track enough capital,
4 obviously you have to be able to make the returns
5 proportionate enough to risk that capital. And as you
6 do that with the size of this kind of marketplace, you
7 either can have a situation where you have to attract a
8 lot of capital with higher costs, or you get cherry
9 picking that takes place within those things that get
10 cleared. In which place, only the higher risk trades
11 or those with lower credit risk, get allocated to the
12 clearing function thereby raising the risks that take
13 place on the clearing side.
14 So has that been analyzed, especially with the
15 level of capital that will be necessary?
16 MS. KLIMPEL: So this is Laura. I'll take that
17 question. So definitely let me talk about the
18 regulation of FICC for a minute because I think it
19 helps to answer the question.
20 So FICC is an SEC registered covered clearing
21 agency. It has been designated as systemically
22 important. And so, it is subject to strict

1 supervision, both by the SEC as its primary regulator,
2 as well as by the Federal Reserve. So the models that
3 we use to charge for margin, charge for liquidity
4 resources that we require are heavily, heavily
5 scrutinized by our regulators. Very, very frequent
6 exams, et cetera.
7 In addition to that FICC is a utility. So we are
8 aligned with our owners in the sense that our owners
9 are also members of the CCP, such that we allocate to
10 each clearing house the regulatory capital that it
11 requires in addition to a corporate contribution to the
12 waterfall.
13 So we believe that those resources, in addition to
14 the margins, liquidity resources, that we charge to our
15 members allow for --
16 [Audio interruption by an unmuted member.]
17 MS. KLIMPEL: Sorry, I think somebody was
18 speaking.
19 They allow us to be able to absorb these, to
20 absorb the cost of increasing the scale of Treasury
21 clearing.
22 And obviously to the extent that more activity

1 will be coming into central clearing, you know, most
2 likely the resources that were required to collect will
3 grow.
4 MR. YAMADA: This is Masahiro Yamada from JP
5 Morgan. Just on that point when you're collecting
6 those resources, is it contemplated that that kind of
7 pool of backstop funds will be distributed amongst the
8 new participants as well? And that those new
9 participants will be held to the same regulatory
10 capital adequacy requirements as the current members?
11 MS. KLIMPEL: So that's a great question. And it
12 depends upon how they come into the clearinghouse and
13 let me explain that.
14 If they come in as a direct member of the CCP,
15 then they will be responsible for if there is a default
16 loss, for example, covering their proportionate share
17 of that loss mutualization just as any other direct
18 member of the CCP.
19 If they come in through a client clearing model,
20 their clearing intermediary will be responsible for
21 those same costs, including the costs of, you know,
22 related to the client's activity, such that every

1 intermediary or member is going to be covering their
2 fair share of the burden. And to the extent that the
3 client and the clearing member, you know, it's part of
4 their business terms. Those potential costs associated
5 with loss allocation could be charged back.
6 So either way. The mutualized costs will be
7 absorbed either by the member itself or by the
8 intermediary, if it's clearing on behalf of the client.
9 CHAIR KARNA: Thank you, Ms. Klimpel, do we have
10 any final questions or comments for this panel before
11 we take a break?
12 As a reminder, it's very helpful if you use the
13 WebEx chat function if you wish to speak to so we can
14 manage this remote environment efficiently.
15 [No response.]
16 CHAIR KARNA: All right. Well, thank you all very
17 much, the second panel has now ended.
18 At this time, we will take 15 minute break before
19 our last panel of the day. Please reconvene on the
20 line shortly before 11:15. Thank you.
21 [Break.]
22 CHAIR KARNA: Welcome back everyone. We will now

1 move onto the third and final agenda item for this
2 morning, which is a series of presentations on the
3 implementation of various rulemakings under Dodd-Frank.
4 There are three presenters for this panel: Tara
5 Kruse, Global Head of Infrastructure, Data and Non-
6 Cleared Margin at ISDA; Kyle Brandon, Managing Director
7 and Head of Derivatives Policy at SIFMA; and Colin
8 Lloyd, Partner at Cleary, Gottlieb, Steen and Hamilton.
9 Please go ahead.
10 MS. KRUSE: Thank you, Angie, this is Tara Kruse.
11 My thanks to Acting Chair Behnam, Commissioner Stump,
12 and the GMAC for the opportunity to present on these
13 important topics.
14 The first one of which is swap data reporting. On
15 November 25th, 2020, the Commission published an
16 amended versions of its Part 45, 46, and 49 swap data
17 recordkeeping and reporting requirements, and it's part
18 43 real-time public reporting requirement. The amended
19 versions of these rules significantly overhauled the
20 list of required reportable data elements with a clear
21 intention to improve the quality and consistency of the
22 data available to the Commission to understand where it

1 is trading practices and exposures.
2 The majority of the changes to the data elements
3 are based on a published list of critical data
4 elements, or CDE, published by CPMI and IOSCO, and
5 developed through collaboration among global
6 regulators, including the CFTC. The incorporation of
7 the CDE by global regulators into their jurisdiction-
8 specific trade reporting requirements is intended to
9 improve consistency and accuracy of reporting data
10 across regimes.
11 The CFTC publication of a separate technical
12 specification for the Part 43 and 45 requirements is
13 helping the industry understand with greater precision,
14 the definition, allowable values, and formats for each
15 data element. Although helpful, the technical
16 specification is not a panacea. Swap data repositories
17 and market participants are working to reconcile
18 inconsistencies between the technical specification and
19 the rules to inform their technical builds.
20 The updated final version of the technical
21 specification was published on September 30th of this
22 year. It's created a chain reaction as HSCR will need

1 to provide updated final messaging specifications and
2 recording counterparties will need to build a
3 corresponding changes to their logic with just seven
4 months until go live. Next slide, please.
5 On May 25th, 2022, the CFTC will be the first
6 regulator to go live with amended trade reporting
7 requirements which incorporate the CDE. The
8 requirement to report a unique product identifier, or
9 UPI, will apply at a later date. Once the UPI system
10 is stood up and the UPIs are ready to be issued by
11 ANNA-DSB, the UPI service provider selected by FSB.
12 A third implementation date is expected once the
13 ISO 2022 standard has been updated and republished to
14 incorporate CFTC-specific data fields. CFTC reporting
15 counterparties, SDRs, and relevant market
16 infrastructures are actively working to implement the
17 amended versions of the Part 43, 45, and 49 rules for
18 next May. However, this is no small feat. Significant
19 resources are required to interpret the new rules and
20 change the reporting logic for the 128 required data
21 elements for various asset classes and a variety of
22 products. Next slide, please.

1 The major challenge with implementing the trade
2 reporting requirements in a consistent, accurate manner
3 has always been the need for parties to translate what
4 is in the written rules into internal code that
5 produces the message sent to their SDR.
6 There is interpretation risk whereby variations in
7 reported data between reporting counterparties for the
8 same field of product result from isolated internal
9 interpretation of the real requirement for a field for
10 various products with unique features.
11 This risk has historically been mitigated in part
12 by best practices agreed in ISDA working groups that
13 address specific use cases.
14 Use of the CDE and the technical specifications by
15 the CFTC introduces more granular instructions into the
16 process, elevating the starting point and reducing the
17 scale of use cases for which interpretation is
18 required. But these written instructions cannot
19 eliminate the risk as it's still necessary to determine
20 for each asset class, each product type, and each
21 variation on a product, which terms of the transaction
22 are appropriate to report and in what form.

1 For example, it's not straightforward for all
2 products, which party should be designated as the buyer
3 versus the seller or the payer versus the receiver.
4 Likewise, it's necessary to determine for each product
5 when a notional quantity should be reported rather than
6 a notional amount. These decisions then need to be
7 transformed into machine executable reporting code.
8 Next slide, please.
9 This is a global challenge and one which ISDA is
10 addressing with the active collaboration of market
11 participants who are contributing their SME knowledge
12 of various products and their coding skills to develop
13 mutualized, open source code for trade reporting, using
14 the common domain model. The digital regulatory
15 reporting initiative or DRR is currently prioritizing
16 the CFTC’s amended rules since they have the earliest
17 compliance date. However, modeling has progressed for
18 the EMIR Refit version of the EU trade reporting
19 requirements and a large percentage of the CDEs which
20 are being coded for CFTC, can be either fully or
21 partially reused for EMIR.
22 As other jurisdictions finalize their amended rule

1 sets, the DRR can be extended by adding any
2 jurisdictional variations on the CDE and jurisdiction-
3 specific fields. Where regulators have adopted the CDE
4 in a consistent manner, the data across regimes will be
5 harmonized.
6 We firmly believe that this mutualized approach to
7 developing reporting code will improve the accuracy and
8 consistency of reporting data by eliminating
9 interpretation risk and will result in a significant
10 resource efficiencies as each firm will not have to
11 build and maintain their own reporting logic from
12 scratch.
13 Should any changes or additions to the code be
14 necessary due to regulatory clarifications or product
15 evolution, these can be made centrally in the updated
16 code deployed by each firm, which has based their
17 implementation on the DRR. Importantly, CDM is open
18 source and therefore regulators will have transparency
19 into the mutualized code and we would welcome the
20 CFTC's involvement and input.
21 Next, I want to move on to compliance dates.
22 There is another implementation challenge here, which

1 is specific to the CFTC, and that's the trifurcation of
2 compliance dates. We recognize that the Commission
3 would like to realize the benefit of the expanded and
4 updated list of reported data, as soon as practicable.
5 However, since the UPI and the ISO messaging standard
6 are not ready for use, it will be necessary to have
7 distinct compliance dates in the future.
8 Introduction of the UPI will require firms to
9 overhaul their internal approach to product
10 identification and the work done to extend product
11 identification for the initial compliance date will no
12 longer be of use. Furthermore, the effect UPI
13 requirement on other data fields and on SDR validations
14 is unclear. It will seemingly require significant
15 changes to the builds which are used from May 25th,
16 2022.
17 Likewise reporting counterparties will produce
18 inbound messages to SDRs in existing formats, like
19 FpML, will no longer be able to use them once ISO 2022
20 is mandated. Next slide.
21 It's the hope to mitigate some of the additional
22 effort created by this trifurcated compliance timeline

1 through the DRR work. For instance, by extending the
2 CDM code to project messaging in ISO 2022. But the
3 most efficient approach to implementation of the
4 Commission's amended rules would be to have a single
5 compliance date along reporting counterparties, SDRs,
6 and market infrastructures to build once to the final
7 end-state and avoid temporary duplicative work.
8 This is the approach expected in the EU and other
9 global jurisdictions.
10 One other item, which I'd like to mention is the
11 Commission's ongoing work on the public dissemination
12 of block trades.
13 In the amended version of Part 43, the Commission
14 retained the previously established dissemination
15 delays and adjusted the minimum block sizes and
16 notional capsizes using an approach which may
17 significantly increase those sizes, making fewer swaps
18 eligible for block trading.
19 The application of these changes is deferred until
20 May of 2023, to allow the industry additional time to
21 adapt and for the commission to receive the enhanced
22 Part 45 data from which it can recalibrate the

1 appropriate minimum block sizes. We encourage the
2 Commission to study the use of the arbitrary 67 percent
3 block threshold and 75 percent cap threshold
4 methodology, and consider the potential impact of an
5 increased shift in block and cap thresholds on trading.
6 Before wrapping up comments on swap data
7 reporting, I'm going to pass to Colin to touch on the
8 cross-border reporting rules.
9 MR. LLOYD: Thanks Tara. And I also want to add
10 my thanks to Acting Chair Behnam, Commissioner Stump,
11 and the rest of the GMAC for inviting us to participate
12 on today's session.
13 So as Tara mentioned, I want to address across
14 border implication of the reporting rules. Since the
15 reporting framework went live, in the beginning of 2013
16 there's either been an exemption or for most of this
17 period, no action relief, which excuses from the Part
18 45 and 46 reporting requirements a non-U.S. swap dealer
19 that is organized in one of several enumerated
20 jurisdictions that doesn't have a U.S. parent company
21 from reporting of swaps of a non-U.S. person that's not
22 a guaranteed or conduit affiliate.

1 The basis for this relief is twofold. One is that
2 the Commission has not yet been in a position to adopt
3 comparability determinations for the enumerated foreign
4 jurisdictions, because a pre-condition to such
5 determination is an ability to obtain direct access to
6 data from the local trade repository and that
7 necessitates in most instances of data sharing
8 arrangement with the local regulatory authority.
9 Secondly, of course, these transactions are ones
10 which have a relatively weak U.S. nexus. They are
11 transactions between a swap dealer, as I mentioned,
12 that does not have a U.S. parent company and is
13 organized in a non-U.S. jurisdiction and a counterparty
14 that's not a U.S. person or a guarantee-kind of
15 affiliate.
16 This relief was most recently extended last
17 November in the No Action Letter 20-37, that relief is
18 due to expire December 1st of next year. December 1st,
19 2022.
20 The purpose of relief was essentially to provide
21 some additional time for the arrangements to be put in
22 place to share data such that the Commission could move

1 forward on comparability determinations. That said,
2 given that those arrangements have not been put in
3 place in the last eight to nine years. One might
4 reasonably question whether this remaining, you know,
5 roughly 12 to 14 months is going to be a sufficient
6 period for those arrangements to be put in place.
7 Meanwhile, the ability for non-U.S. swap dealers
8 relying on relief to be able to report their
9 transactions with the affected non-U.S. counterparties
10 continues to be impeded by the need to get consent from
11 those counterparties in order to surmount various non-
12 U.S. privacy laws, as well as in many instances, very
13 significant technological and operational changes in
14 order to address infrastructure, particularly those in
15 distant foreign branches, which are not set up to
16 report the affected transactions to a U.S. swap data
17 repository.
18 This suggests that it may not be feasible within
19 the next 12 to 14 months for the affected firms, and in
20 fact, to build out the capability to report the
21 affected transactions, particularly if they are still
22 waiting on some signal from their local regulators and

1 the Commission that some form of substituted compliance
2 or other relief will not be granted.
3 I would also note that the cross-border
4 application of Part 45 and Part 46 was not addressed in
5 the cross-border rulemaking the Commission undertook
6 during 2020, which focused on Part 23 obligations and
7 therefore continues to be governed by the 2013 cross-
8 border guidance.
9 One possible way to address these matters would be
10 for the Commission to undertake a review of that
11 guidance and whether it continues to be appropriate or
12 whether it might instead be appropriate to codified the
13 No Action relief that has been in place for the last
14 eight-plus years. Or alternatively, whether a further
15 extension might be the necessary possibly as a bridge
16 to such a rulemaking.
17 At bottom, I would suggest, however, that the
18 current situation where we have a No Action Letter
19 that's due to expire in a little over a year's time,
20 coupled with the long lead time needed for
21 implementation means that this particular topic is one
22 which needs to be on the Commission's agenda in one

1 form or another in order to avoid some measure of
2 disruptions to the marketplace come the December 2022
3 deadline. Thank you.
4 MS. KRUSE: Thanks Colin. And now moving onto
5 uncleared margin. The Phase 5 regulatory IM compliance
6 date of September 1st, 2021 has come and gone without
7 notable impact to the derivatives market. This can
8 certainly be credited in no small part to the actions
9 taken by the Commission and other regulators to first
10 split the final phase of IM implementation into two
11 phases.
12 And then, defer those phases for a year following the
13 onset of the COVID-19 pandemic.
14 These actions provided valuable time for Phase 5
15 entities, their asset managers, their dealer
16 counterparts, custodians, and market infrastructure
17 providers to prepare for compliance. Also key to an
18 orderly preparation with the clarification provided by
19 the Commission the documentation and custodial
20 arrangements may not be completed in advance of an
21 obligation to exchange initial margins.
22 This has allowed swap dealers and Phase 5

1 entities to prioritize relationships based on the
2 anticipated runway to IM exchange and resulted in a
3 two-lane approach whereby some relationships were
4 designated as a priority for September 1st and others
5 were designated for IM monitoring.
6 An informal survey conducted by ISDA with a subset
7 of dealer and buy-side members suggests that
8 approximately 46 percent of Phase 6 relationships are
9 currently in the lane for September 1st, while 54
10 percent are designated for IM monitoring. Despite
11 concerted effort, not all relationships designated for
12 September 1st were ready by then. ISDA information
13 suggests roughly a 39 percent completion rate, meaning
14 the relevant credit support documentation and custodial
15 arrangements were in place. And importantly, the
16 parties were operationally ready to exchange IM.
17 Despite that limited completion rate, there was
18 not notable disruption to the market as firms
19 concentrated trading and the relationships that were
20 operational or worked within the boundaries of their IM
21 thresholds. Since September 1st progress has been made
22 on those prioritized relationships. And our latest

1 information suggests a 67 percent completion rate. The
2 concern regarding this tail is that Phase 6 efforts are
3 delayed as resourcing at dealers and custodians is so
4 focused on Phase 5. This will have a knock-on effect
5 on how many Phase 6 relationships can be ready for
6 September 1st, 2020. Next slide.
7 As a number of Phase 6 relationships is expected
8 to be doubled out of Phase 5, it's a safe prediction
9 that there will be major backlogs and bottlenecks.
10 This slide displayed are our estimates from the 2018
11 ISDA study. These figures have held up pretty well,
12 though some groups have shifted from the Phase 5 bucket
13 to Phase 6 through increased clearing counterparty
14 diversification and portfolio optimization efforts.
15 Phase 6. ISDA is actively discussing the
16 challenges from Phase 5 with buy-side parties, swap
17 dealers and custodians to understand lessons learned
18 and discover opportunities for improvement. We know
19 that these challenges will be amplified in Phase 6,
20 through the increased number of counterparties and
21 relationships and the decreased level of experience
22 with regulatory IM project and legal resourcing, and

1 margin call settlement, and dispute management
2 automation.
3 It's important to remain cognizant of the reasons
4 why IM preparation is more challenging for Phase 5 than
5 it was for Phases 1 to 4 and why those challenges would
6 be exacerbated for Phase 6.
7 So it's a scale of relationships as mentioned, and
8 the type of firms and entities plays a role.
9 The nature of these counterparties means there are
10 substantive differences in the requirements for
11 preparation and the approach to compliance. Phase 6
12 will capture more pension funds, insurance companies,
13 and other end-users whose derivatives portfolios are
14 managed by asset managers. Many are newly acquiring an
15 understanding of the regulatory IM requirements and
16 have limited resourcing and technical sophistication to
17 implement the end-to-end the process flows, let alone
18 automate them.
19 Phase 6 will capture a greater number of parties
20 located in a wider range of jurisdictions where IM
21 custodial offerings are not widely established and
22 there may be uncertainty on the enforceability of

1 netting agreements or the ability for the secured party
2 to receive collateral in the event of certain default.
3 I'd like to highlight three areas which posed
4 significant challenge for Phase 6: custodial
5 onboarding, separately managed accounts, and
6 automation. This is by no means an exhaustive list.
7 First with respect to custodial onboarding. One
8 of the key themes in postmortem discussions of Phase 5
9 is custodial onboarding. In prior IM phases, tri-party
10 agents were the norm. Dealers were generally well-
11 equipped to navigate the KYC requirements and account
12 control agreements were for the most part non-
13 negotiable. With a limited number of tri-party agents,
14 the plausible combination with custodians for pledging
15 and receiving were manageable and delays in account
16 activation were limited.
17 Most Phase 5 and 6 clients will use third-party
18 custodians designed to serve the needs of smaller
19 parties who may not need the sophisticated collateral
20 evaluation, selection, and validation services of a
21 tri-party provider. Contrary to the approach for tri-
22 party custodians, the account control agreements for

1 third-party custodians are heavily negotiated. First
2 for client preferences and then for the preferences of
3 the dealer who will receive the collateral under that
4 arrangement.
5 KYC requirements can also be extensive and vary by
6 custodian. Phase 6 terms will not only need to be KYC
7 by the custodian that they have selected for posting
8 collateral, but will need to be KYC by the custodian
9 chosen by each of their dealer counterparties from
10 which they will receive collateral. These processes
11 can be very time and resource consuming.
12 Since Phase 1, tri-party agents have improved
13 their onboarding process with online tools, but there
14 are still many jurisdictional and regulatory specific
15 KYC requirements, as those pledging and receiving
16 counterparties are required to meet.
17 As they did for Phase 5, custodians are expected
18 to set individual deadlines for the submission of
19 onboarding documentation in Q1 or Q2 of 2022. Parties
20 which do not submit their completed paperwork on time,
21 will have their accounts opened on a best efforts
22 basis.

1 Custodians already supporting regulatory IM
2 requirements are examining their resourcing for Phase 6
3 and determining whether there are any ways that can
4 make their onboarding processes more efficient.
5 Meanwhile it's imperative that Phase 6 entities
6 disclose their expected or known Phase 6 status to
7 their dealers, identify their preferred secure product
8 custodian, and begin those KYC processes as soon as
9 possible.
10 Now, turning to asset management. A large portion
11 of Phase 6 entities have their derivatives portfolio
12 managed by asset managers. A single entity, such as a
13 pension fund or endowment might have multiple asset
14 managers to execute different strategies on their
15 behalf. This is referred to as a separately managed
16 account. Because the rules are written to specify
17 legal entity rather than SMA when determining material
18 swaps exposure, IM thresholds, and minimum transfer
19 amounts, this preparation is complicated by the
20 dependency the asset manager has on information and
21 decisions by its clients.
22 Only the underlying client can determine its

1 material swaps exposure, until notification is made to
2 the asset manager that the client expects to breach the
3 $8 billion threshold. The asset manager cannot begin
4 preparation on its client's behalf. In addition to the
5 asset manager is beholden to its SMA client to
6 determine the division of the IM threshold among its
7 managed accounts.
8 The same is true for MTAs, except under the CFTC
9 requirements. With varying degrees of awareness and
10 resources, some clients will not make these disclosures
11 and determinations in time to work with their asset
12 manager to meet September 1st.
13 Turning to automation. Automation, or the lack
14 thereof, on the part of Phase 5 and 6 entities will
15 prove challenging for both regulatory IM and IM
16 compliance.
17 The industry is still vastly dependent on emails,
18 accessing multiple custodian portals, and sending wire
19 transactions with manual intervention. Specific to
20 third-party custodian structures in segregated
21 accounts, secured parties provide authorization to
22 release excess collateral back to the pledger via fax

1 and with manual review of authorized signatures.
2 Although there were efforts to automate margin call
3 communication, collateral allocation, collateral
4 affirmation communication, settlement and release of
5 collateral. There is still much work to do, especially
6 with smaller entities that are on Phase 6.
7 Automation can improve operational, counterparty,
8 and liquidity risk management. However, margin call
9 and settlement volumes will likely have to increase
10 before smaller entities move toward automation instead
11 of increasing human resources with manual processing.
12 I'd be remiss if I didn't highlight some
13 opportunities that Phase 6 entities and their
14 counterparties can leverage to help ease the glide path
15 to September 1st.
16 First and foremost, perspective Phase 6 entities
17 must conduct estimated MSE, or average aggregate
18 notional amount calculations, as soon as possible and
19 disclose their Phase 6 status to their counterparties.
20 They can do this by any method they choose or leverage
21 bilateral or multilateral methods supporting by ISDA.
22 Secondly, Phase 6 firms and their dealer

1 counterparties can negotiate their collateral support
2 agreements using ISDA Create, an online negotiation
3 tool, which offers output in CDM for internal
4 consumption of negotiated terms and distribution to
5 collateral management vendors.
6 Lastly, I encourage Phase 6 firms and their
7 counterparties to expedite the negotiation of their
8 eligible collateral schedules using one of a number of
9 eligible collateral templates, which ISDA has
10 published. These templates include the intersection of
11 eligible collateral for key jurisdictions, five tri-
12 party custodians have created their own versions of
13 these templates for use alongside their custodial
14 account agreements.
15 Finally, I'd like to round up my comments by
16 circling back to the work of this committee and the
17 Commission. On April 27th, 2020, the GMAC Subcommittee
18 on Margin Requirements for Non-Cleared Swaps submitted
19 a report to the GMAC with recommendations to improve
20 scoping and implementation of initial margin
21 requirements for non-cleared swaps. On May 19th, 2020,
22 the GMAC endorsed the report, voting in favor of

1 adopting the recommendation.
2 The Commission acted on the recommendations in the
3 report by amending the non-cleared margin requirements
4 to first align the method and timing of the material
5 swaps exposure calculation, and the post-phase-in
6 compliance dates with that of global jurisdictions.
7 And also to codify relief, which allowed separately
8 managed accounts to have distinct minimum transfer
9 amounts.
10 These actions on the part of the Commission are
11 greatly appreciated by market participants. There are
12 other recommendations in the report that would provide
13 meaningful assistance for Phase 5 and 6 firms. I would
14 encourage the commission to consider addressing more of
15 these.
16 For instance, eliminating undue restrictions on
17 the activities of eligible money market funds to
18 transfer assets through sec lending, sec borrowing,
19 repurchase agreements, and reverse repo agreements.
20 These restrictions severely limit the availability of
21 money market funds that can be used in the U.S. and
22 make it impossible to use money market funds, cross-

1 border with the EU and UK.
2 Secondly, provide an exemption from the
3 consolidation of seeded funds with their sponsors for
4 purposes of calculating AANA and MSE during the limited
5 seeding period to provide a level playing field for
6 these seeded funds.
7 Finally, in accordance with the approach the
8 Commission has adopted on MTAs, allow each separately
9 managed account to be treated as a distinct entity, to
10 which a separate regulatory IM threshold could apply.
11 Before concluding comments on the non-cleared
12 margin implementation. I'd like to pass the microphone
13 to Kyle, to touch on portfolio margin.
14 MS. BRANDON: Thank you, Tara. And thank you also
15 to Acting Chairman Behnam and Commissioner Stump,
16 Andree Goldsmith, Angie Karna, and the rest of the GMAC
17 members for the invitation to speak with you today.
18 I’m looking at margins -- I'm going to touch on
19 portfolio margin just for a few minutes, I know it's
20 been awhile, but back in late-2020 SIFMA responded to a
21 joint CFTC-SEC request for comment on potential ways to
22 implement portfolio margining of uncleared swaps and

1 uncleared security-based swaps. Although staff at both
2 Commissions have not yet had the bandwidth to move
3 forward in this area, we hope by highlighting its
4 importance whenever given the opportunity, it will find
5 its way back onto the front burner soon.
6 As a reminder, once SBSD registration-related
7 rules apply in the coming days, non-bank swap dealer
8 security-based swap dealers, subject to separate and
9 somewhat different margin and segregation regimes, will
10 be at a disadvantage to bank SD/SBSDs, which are able
11 to offer customers the ability to margin a wider range
12 of related products under a consistent regulatory
13 framework. As a consequence, the market as a whole may
14 experience some increase in liquidity, settlement, and
15 operational risks as a result for the non-bank SD/SBSDs
16 to exchange and custody margin separately for swaps and
17 SBS and securities positions.
18 As the Commissions both noted in the release,
19 portfolio margining would, by ameliorating these
20 issues, offer substantial benefit to both market
21 participants and the securities and derivatives markets
22 as a whole. These benefits would include greater

1 alignment of margin requirements and the associated
2 costs with the overall risk of a counterparty's
3 portfolio, more efficient collateral management,
4 increased liquidity, and reduced volatility.
5 We also agree with the Commissions, that in a
6 portfolio margining arrangement should take the account
7 of the customer protection, financial stability, and
8 other regulatory objectives that undergird the
9 Commissions' respective margin and segregation
10 requirement.
11 In our submission, we suggested a limited number
12 of actions to address the range of trading
13 relationships that will become subject to margin and
14 segregation requirements of both Commissions upon the
15 initial implementation of the SEC's rules. We also
16 noted, however, that additional relief may be necessary
17 before initial margin requirements fully phase-in on
18 September 1st, 2022.
19 We would welcome the opportunity to take up
20 portfolio margining with both Commissions as soon as we
21 are on the other side of settling into the new CFTC
22 capital rules and the SEC regime, but in time to

1 address these disparities that will become more
2 prominent once the uncleared rules are fully phased in
3 next September. Thank you.
4 CHAIR KARNA: Thank you Ms. Kruse, Ms. Brandon,
5 and Mr. Lloyd. The floor is now open for questions and
6 comments on the presentation.
7 As a reminder, if you have any questions or
8 comments, please indicate so in the WebEx chat function
9 on the bottom right of your screen, and I will call
10 upon you.
11 MS. BRANDON: Ms. Karna, I just wanted to check if
12 you wanted to do questions on the reporting in margins
13 first and then our little presentation on capital, or
14 should we do the capital presentation first?
15 CHAIR KARNA: Let's go to capital. I apologize.
16 I wasn't sure if you were finished or not.
17 MS. BRANDON: Oh, sorry. Then I'll turn it over
18 to Colin Lloyd to kick-off the capital presentation.
19 Sorry, apologies, Colin. I think it might be
20 actually up to me to kick-off the capital presentation.
21 MR. LLOYD: I’m happy to let you take the floor
22 first, Kyle.

1 MS. BRANDON: Sure. I'm going to be addressing
2 specifically the -- some of the cross-border issues of
3 the capital rule since that's where SIFMA members have
4 been most focused in recent days and there are still
5 the most open issues.
6 And I'd like to start by thanking the Commission
7 staff for their engagement on substituted compliance
8 for the capital rule. And while the process wasn't
9 completed for all the applications by the October 6th
10 go live for the capital rule, we believe that a
11 significant amount of progress was made during a time
12 when there were a lot of other things going on, such as
13 the considerable work needed to address the post-Brexit
14 regime, transition to new reference rates, and the
15 continued implementation of the uncleared margin
16 regime, and all done in a remote work environment.
17 And we're thankful for the time limited, no action
18 position taken by staff to act as a bridge to the
19 completion of those substituted compliance orders.
20 So there is one forward looking comment I wanted
21 to make in regards to the orders that we expect to be
22 proposed in the coming year. The CFTC widely

1 acknowledged that swap dealers are, for the most part,
2 either themselves global entities or are part of global
3 groups established all over the world and did include
4 in their capital rules the option for firms to rely on
5 so-called bank-based approaches, which are generally
6 consistent with the globally accepted Basel capital
7 standards, in addition to an SEC-style net capital
8 approach.
9 This means that both U.S. swap dealers and non-
10 U.S. swap dealers seeking to rely on subcomps may rely
11 on currently utilized bank-style standards and
12 methodologies, which do differ from the net capital
13 approach traditionally applied to broker-dealers and
14 FCMs.
15 Looking at U.S. non-bank swap dealers: for those
16 using the net capital approach, the binding constraint
17 on minimum capital requirements will be the so-called
18 risk margin amount, which is based on U.S. concepts.
19 The firms using the bank-based approach, the binding
20 constraint on minimum capital requirements will be a
21 percent of risk-weighted assets, which is based on the
22 Basel-style calculation.

1 These firms, however, using the bank-based
2 approach are still required to calculate the risk
3 margin amount to compare with the RWA. But by virtue
4 of what goes into the respective calculations, the RWA
5 will surely be a larger amount and therefore a binding
6 constraint. For these firms relying on the bank-based
7 approach, calculating the RMA may not be a good use of
8 the scarce resources they have, that does not yield
9 useful information for capital purposes.
10 Turning back to the non-U.S. non-bank swap
11 dealers, we understand that there's still discussion
12 ongoing as to whether the Commission will require an
13 RMA calculation as a condition for non-U.S. firms using
14 bank-based capital standards to be allowed to rely on
15 substituted compliance.
16 It would require significant effort to overlay
17 U.S. calculations over home country calculations.
18 Therefore, somewhat defeating the benefit of permitting
19 substituted compliance and the comity it implies.
20 Given that most non-U.S. jurisdictions have adopted
21 fully loaded Basel-III requirements with various
22 buffers in excess of the 8 percent RWA calculation

1 required by the CFTC, such an additional condition
2 should be unnecessary. It would be far more consistent
3 with a substituted compliance approach that, if the
4 Commission believes the jurisdictions requirements to
5 be lacking in some specific and identifiable way, then
6 it should base any deemed necessary conditions on the
7 home country's financial reporting and capital regime,
8 rather than adding a condition based on U.S. style
9 information and calculations.
10 And one other area for non-U.S. swap dealers, I
11 wanted to just make a mention of financial reporting
12 for non-U.S. bank swap dealers. And we sincerely
13 appreciate the active dialogue on making substituted
14 compliance available for non-U.S. bank swap dealers'
15 financial reporting and appreciated the relief that was
16 granted to bridge to a more permanent approach.
17 And as the Commission recognizes, bank swap
18 dealers are subject to prudential, not CFTC, capital
19 standards. And for U.S. bank swap dealers, the
20 Commission does accept financial reporting that follows
21 the bank regulators' requirements – the so-called call
22 reports.

1 Non-U.S. bank swap dealers in G20 jurisdiction
2 subject to Basel capital standards follow their home
3 country capital standards and prepare financial
4 statements according to their home country's accounting
5 principles. And requiring them to submit financial
6 reports in accordance to U.S. GAAP and capital
7 standards would be an unjustified burden as you
8 recognized and agreed temporarily to permit an English
9 translated U.S. dollar versions of their home country's
10 balance sheet and regulatory capital standards or for
11 those dually registered with the SEC focused Part 2c
12 reporting, according to the SEC manner and format order
13 for the covered non-U.S. bank SBSDs.
14 The relief set out in No-Action 21-18, set to
15 expire on October 6th, 2023, upon adoption of
16 superseding Commission action to address this issue.
17 And we look forward to such permanent relief being
18 proposed and we're commenting on it, and we'll continue
19 to actively engage with the Commission staff during the
20 process.
21 Thank you. And we look forward to working with
22 you on future actions. Colin.

1 MR. LLOYD: Thanks, Kyle. I just wanted to
2 briefly touch on three implementation issues that we
3 had seen in conjunction with the recent October 6th
4 compliance date from the Commission's capital rules for
5 non-bank swap dealers.
6 The first, which Kyle alluded to, in a non-U.S.
7 context, is this requirement for a non-bank swap dealer
8 to maintain capital equal to some percentage of its
9 uncleared swap margin amount, which is an amount
10 computed based off of the calculation of initial margin
11 requirements for an uncleared swap, foreign exchange
12 swap, or foreign exchange forward with a counterparty
13 and it extends only to those trading relationships that
14 are in scope for initial margin requirements, but also
15 other open positions that the swap dealer has.
16 This requirement has presented some significant
17 implementation issues on account of the fact that the
18 various systems and processes that are used to
19 calculate initial margin requirements are only set up
20 in most instances to apply to those relationships that
21 are in scope for initial margin.
22 So for example, the data which feeds initial

1 margin calculations typically is only data for those
2 relationships and specifically those credit support
3 annexes that are turned on for regulatory initial
4 margin, such that portfolios which are not subject to
5 those rules, do not feed the relevant calculators. In
6 addition, some of the calculation methodologies,
7 particularly in a model-based approach to initial
8 margin may depend on elections that are made on a
9 counterparty specific basis around such matters as the
10 treatment of securities indices, as well as currency
11 conversions.
12 As a consequence of this, it is very difficult for
13 many firms to perform the uncleared swap margin
14 calculations while at the same time, those calculations
15 often are not informing the firms binding constraint
16 from a capital perspective as Kyle noted.
17 This was a set of issues, which the SEC in their
18 rules addressed recently for a Staff FAQ. Their rules,
19 likewise, provide for a similar calculation called the
20 risk margin amount for security-based swaps and in
21 light of the difficulties, which I just mentioned the
22 SEC adopted an FAQ position until next September 1st,

1 permitting a firm which is subject to these
2 requirements instead to calculate initial margin amount
3 and using the potential future exposure or maximum
4 potential exposure calculations that it already does
5 for credit risk charged capital purposes.
6 This is something which industry have discussed
7 with CFTC staff, and we hope to get the staff's input
8 shortly. But it is a material issue with the rules
9 that will be particularly significant once the initial
10 financial reports for U.S. non-bank swap dealers are
11 due next month.
12 The second issue, which I wanted to mention,
13 implementation issue, is that which is a crossover with
14 the SEC, is that a handful of firms which are dual
15 registrants with the Commission and will be registering
16 with the SEC in a few days as security-based swap
17 dealers are electing an approach under the SEC rules
18 called the alternative compliance mechanism, which
19 provides them with relief from various SEC capital and
20 other financial responsibility rules on the condition
21 that they comply with parallel Commission rules and do
22 so with application, not only to their Commission

1 regulated swaps business, but also their security-based
2 swap business.
3 While this framework makes a lot of sense, and as
4 much as it's tailored to address situations where the
5 Commission has a much more significant regulatory
6 interest in the firm and the SEC has a consequence of
7 its limit, the firm's limited security-based swap
8 business. A number of questions remain outstanding in
9 terms of how this so-called ACM will be administered in
10 practice. And so, we would expect over the coming
11 months that the Commission and SEC staff will need to
12 coordinate in terms of how the affected firms will
13 apply Commission requirements to security-based swaps
14 and how those requirements will be overseen.
15 A third, and final, point that I wanted to note
16 relates to the ability to use internal models to
17 compute market and credit risk charges for capital.
18 Again, for non-bank swap dealers. There are -- most of
19 the firms which have registered as non-bank swap
20 dealers are either a legal entity or a consolidated
21 group level or one of their affiliates, subject to
22 another regulators capital requirements for which they

1 have elected the ability to use internal models. And
2 therefore they have taken advantage of a provision in
3 the Commission's rules, which allow for provisional use
4 of those models subject to an application being
5 submitted to the Commission, or in reality the NFA to
6 review those models. And then there will be a review,
7 which will take place post-compliance date.
8 On the other hand, there also are a handful of
9 firms which do not have approved models elsewhere in
10 their organization and which had been in discussions
11 with NFA around model approval. These discussions have
12 been difficult at times. There are some No Action
13 Letters, which are referenced on the Commission's
14 website that address some of these firms.
15 But I think that the takeaway is that the model
16 review process is a significant undertaking, both for
17 firm in question, as well as NFA staff and a
18 significant amount of time and resources are necessary
19 to complete that process. And so, it does appear that
20 for many of the firms there was not sufficient time
21 prior to the compliance date for that process to be
22 completed which has led to, as I mentioned the need for

1 some, some relief in some cases.
2 And in addition to that we do expect that in the
3 coming months, NFA will continue its process for
4 reviewing the models that firms are using, which have
5 been approved by other regulators. I think in that
6 connection, it will be important for Commission and NFA
7 staff to do an account of the guidance which the
8 affected firms have received from their other
9 regulators in regards to the use of models,
10 particularly where those models are meant to conform to
11 Basel standard as administered by those other
12 regulators and changes to the model review and model
13 risk management framework at those firms, will require
14 a consultation/coordination with the other affected
15 regulators. And certainly for those firms which don't
16 have model approvals from other regulators, that there
17 will likely to be a continuing dialogue with the
18 Commission, so as to ensure that those firms do not
19 face an unlevel playing field vis-à-vis the other
20 firms.
21 Thank you. That that ends my, a portion of the
22 present.

1 CHAIR KARNA: Thank you, Mr. Lloyd, Ms. Brandon,
2 and Ms. Kruse. The floor is now open for questions and
3 comments on all three of these presentations from our
4 third panel. And as a reminder again, please use the
5 WebEx chat function if you wish to make any comment or
6 raise any questions.
7 Ms. Kong, I believe you have a comment or
8 question, please go ahead.
9 MS. KONG: It's just a comment following on Ms.
10 Kruse’s summary about the implementation issues
11 impacting U.S. non-bank swap dealers. I think she's
12 made an elegant description about the three issues so I
13 won't spend more time elaborating, but it will be
14 really good if the Commissioners and the CFTC look into
15 the potential costs and difficulty and time we'll need
16 for the non-bank swap dealers to implement the IM, the
17 model validation rules. So from a BPAC [phonetic]
18 perspective, we do find that challenging given the
19 current timeline.
20 CHAIR KARNA: Great. Thank you very much, Ms.
21 Kong.
22 Any other comments or questions for our panelists?

1 Ms. Belich, please go ahead.
2 MS. BELICH: Thank you very much, Angie. Yeah,
3 just a quick comment related to Ms. Kruse's
4 presentation related to swap data reporting.
5 I think in addition to the cross-border issues and
6 technological and operational issues that Mr. Lloyd
7 also outlined. Normally, from a cross-border
8 perspective, but in line with current no-action relief
9 one thing that the compounds, I think the issues
10 surrounding implementation with the CFTC rewrite and
11 other trade reporting requirements that are similarly
12 coming into implementation in 2022 and 2023, is that in
13 many jurisdictions outside of the U.S. look to the
14 CFTC’s rulemaking and guidance as a way to engage in
15 rewriting of their own rules and really following suit
16 to what they see the U.S. market doing.
17 And so, I think the importance around some of
18 those issues, again, from a coding standpoint,
19 interpretation of very technical and certain, you know,
20 complex you know, scenarios and decision-making
21 based on certain products including, you know, things
22 that are currently outlined as conditional or required

1 or optional based on product type or relationship, I
2 think are becoming increasingly important that, you
3 know, firms have an appropriate amount of time to
4 review those aspects given that from a home
5 jurisdiction perspective there will be following of
6 suit in many cases along with that rulemaking.
7 And so, you know, if firms are faced with those
8 issues from a U.S. perspective, they would similarly
9 face similar issues within their home country as well.
10 Leading to not only more issues, but potentially more
11 fragmentation in terms of how they interpret and tackle
12 those rules.
13 And kind of last point on that, is that the data
14 integrity is just as important to firms from a
15 reporting standpoint, as it is to the regulators and
16 other market participants that utilize it. And so,
17 certainly there's a keen interest, you know, by the
18 foreign banks to have information that they report
19 under the new rules accurate and complete not only for
20 the regulators and the market as a whole, but for their
21 own purposes as well.
22 CHAIR KARNA: Thank you very much, Ms. Belich.

1 Does anyone else have any questions or comments
2 for our panelists?
3 MR. TWIGGS: Hi, this is this Thane Twiggs from
4 Cargill. I apologize, I couldn't get the WebEx to
5 work.
6 CHAIR KARNA: Please go ahead Mr. Twiggs.
7 MR. TWIGGS: Thank you. One thing I'd just like
8 to say about the new capital rule is it's not just non-
9 bank, not foreign entities that are having difficulty
10 with the capital rules, I think internally some of the
11 -- or in the U.S., some of the ideas that were
12 discussed by Mr. Lloyd also are difficult for U.S.
13 participants as well. And I think, I'd appreciate
14 continued dialogue with the Commission and staff on the
15 rule.
16 So I think it's an important point to remember for
17 the non-U.S., but also for the U.S. non-bank swap
18 dealers as well. Thank you.
19 CHAIR KARNA: Thank you, Mr. Twiggs.
20 Does anyone else have any questions or comments
21 for our panelists or other GMAC members?
22 [No response.]

1 CHAIR KARNA: All right. Thank you very much to
2 our third panel, I will now turn it over to Andree to
3 finish out the day's agenda.
4 MS. GOLDSMITH: Thanks Angie. Thanks to all of
5 the presenters today and to our GMAC members for your
6 engagement in today's presentation. I'm now going to
7 turn it over to the Commissioners for any closing
8 remarks.
9 Chairman Behnam, are you still on?
10 [No response.]
11 MS. GOLDSMITH: Okay. I think he may have had to
12 drop off a little bit early. In that case I will move
13 on to Commissioner Stump.
14 COMMISSIONER STUMP: Thanks Andree. And thanks
15 Angie for running the meeting today and all of the
16 presentations were great. And members of the
17 committee, thanks for your engagement as well.
18 Just a few closing comments based upon what I
19 heard. I want to start with the Treasury market
20 discussion. We've wanted to have this conversation for
21 some time, but we thought we needed time to conduct a
22 well-informed analysis that we heard today and look

1 retrospectively and also to set the record straight as
2 to who was actively selling and who was active as a
3 liquidity provider and who was not, and why.
4 I think, you know, we as a commission and we as an
5 industry and the market infrastructure providers, we
6 have to, we all know we don't operate in a 2020 or 2021
7 vacuum. And we cannot ignore the impact of the
8 necessary post-crisis reforms on the traditional
9 liquidity providers. I think it was well-established
10 and very tactfully put that the dealers balance sheets
11 are more constrained and with the new regulatory
12 capital requirements, and yet the Treasury market
13 continues to grow.
14 And so, we have to think about things in that
15 context, and I recognize that some of the potential
16 paths forward involve other oversight bodies well
17 beyond the CFTC, but the implication to our markets,
18 the derivatives markets, make it necessary for us to
19 engage. And I think today's presentations coupled with
20 the benefit of the input from the Advisory Committee,
21 better enable us to do that.
22 So again, I recognize this was of interest to

1 everyone, but at the same time, well beyond and more
2 expansive than the CFTC’s mandate, but I think it's
3 such an important thing for us to continue to focus on.
4 So thanks to everyone for engaging.
5 And I also -- turning to the second panel. I
6 mean, our work is never done. It doesn't matter how
7 long it's been since the advent of the financial crisis
8 or the implementation of our Dodd-Frank rules. We
9 always have to be willing to dynamically look at things
10 and consider them in the current context and I'm not
11 going to talk about all of the various rules that we
12 are covering here, and the various things that continue
13 to perplex those who are tasked with implementing them.
14 But I think that you know, I will say a word, just a
15 quick word about it.
16 It's been over a year since we reworked our swap
17 data rules and it was frankly, a labor of love for so
18 many people at this agency. And as I pointed out then
19 September 2020, it was important then, and it continues
20 to be important, that immediate attention be given to
21 substituted compliance determination for swap data
22 reporting. The various folks who are engaged in that,

1 I think we heard very loudly and very appropriately
2 today that that remains critical. And as a year has
3 passed, other things have come into consideration.
4 There is relief. That's outstanding. There are
5 cross-border guidance that is applicable here, and we
6 need to give a holistic view, a holistic consideration
7 to what's next with regard to making swap data
8 reporting workable. I mean, over 50 percent of our
9 swap dealers are non-U.S. persons. So it stands to
10 reason that we have to give this very thoughtful
11 consideration.
12 I think it's well-established I have publicly
13 expressed my concern with the process that surrounded
14 the development of the block trade threshold rules and
15 I continue to believe we would benefit from publishing
16 the calculated block sizes with the new categories and
17 having a roundtable or a hearing. And while that was
18 the commitment I received from the former Chairman, I
19 still believe it would be worthwhile.
20 So I think that with regard to swap dealer
21 capital, we are aware and I wanted this group to know,
22 we hear you, that there are things that will continue

1 to require our attention to making that rule workable.
2 And I want to commend the division of -- the Market
3 Participants Division for their efforts in the past few
4 months to really focus on substituted compliance.
5 But I think we've all had many conversations and
6 we recognize that there's more work to do and we look
7 forward to doing that. I could go on.
8 There's so many things we are not lacking for
9 initiatives and opportunities to improve upon what
10 we've already done. You all know how I feel about the
11 uncleared margin rules. I'm very thankful to this
12 committee and to the subcommittee that worked so hard
13 to come up with, you know, things that would make this
14 rule in the event of uncleared margin more workable.
15 And I think that's where we all have to focus now.
16 Like what, what makes sense in the current
17 context? We don't live in 2008, 2009, 2010, or even
18 2015 anymore. So, we live in 2021 and we have to think
19 about what makes sense.
20 So with that, just one more thanks to Andree for
21 her efforts and her ability to take what is normally a
22 very big picture idea that I have relative to the

1 agendas for these advisory committees and making them
2 all come together and in a remarkable way.
3 So thanks Andree. And we wish you well in your
4 next chapter. And we look forward to having a new DFO
5 sometime soon and further engagement with the GMAC.
6 Thanks to everyone for participating. Thank you.
7 MS. GOLDSMITH: Thank you.
8 OPERATOR: Thank you all for participating in
9 today's conference, you may disconnect your line and
10 enjoy the rest of your day.
11 (Whereupon, at 12:10 p.m. EST, the meeting of the
12 Global Markets Advisory Committee was adjourned.)
13
14
15
16
17
18
19
20
21
22