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COMMODITY FUTURES TRADING COMMISSION

PUBLIC ROUNDTABLE:

CPMI-IOSCO GUIDANCE ON CCP RESILIENCE AND RECOVERY

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

2 (9:00 a.m.)

3 MR. BANDMAN: Good morning, everybody.
4 Thank you for joining the CFTC's roundtable on the
5 PFMI's consultative guidance regarding the
6 resilience of clearinghouses. We very much
7 appreciate your joining us today. We thank you
8 for the prompt beginning. There are, in addition
9 to the folks here, there are also folks from the
10 CFTC regional offices as well as people who are
11 listening over the phone, and look forward to a
12 very interesting discussion.

13 I'll be giving further remarks in a
14 moment, but I would like to introduce the Chairman
15 of the CFTC, the honorable, Tim Massad, to speak
16 to us.

17 MR. MASSAD: Well, thanks, Jeff. I'm
18 just going to say a brief word and, first, welcome
19 to everyone. Thank you very much for being here.
20 This is very, very helpful to the process. As you
21 all know, we're holding this in conjunction with
22 or as part of the CPMI/IOSCO policy study group

1 process on resilience and recovery.

2 That process is, of course, one of four
3 work streams that were agreed to by the chairs of
4 the FSB, the BCBS, CPMI and IOSCO to look at
5 clearinghouses. So it's an incredible amount of
6 work going on, very, very good work to look at CCP
7 resilience, recovery, and resolution. This is a
8 critical piece of that.

9 With respect to this piece, as you know,
10 the consultation document was published in August.
11 The goal is to have some guidance to the FSB or to
12 the G-20, I should say, by the time of the G-20
13 meeting in July. All this discussion of these
14 issues also compliments the domestic work that we
15 at the CFTC are doing on resilience, recovery, and
16 resolution. As you know, we're actively engaged
17 with the CCPs that need to have recovery and
18 plans, and working on getting those done by the
19 end of the year, and also working with the FDIC on
20 resolution.

21 So this is, frankly, to me, at the top
22 of our agenda. It's one of the most important

1 things we're doing. Having said that, I'm not
2 going to apologize for the fact that because this
3 is also IMF week and there's, as you know, a slew
4 of foreign visitors in town I can't stay, as much
5 as I'd like to, and listen to this.

6 But I look forward to hearing from Jeff
7 and Bob and John and Tracey and everyone on our
8 team, how it went, and eventually seeing the
9 transcript. So, thanks again.

10 MR. BANDMAN: Thank you very much,
11 Chairman Massad. I'd also like to recognize
12 Commissioner Bowen who's in the audience. We
13 thank you very much for your support today.

14 So, as the Chairman said, today's
15 gathering, it's a very important topic. It's very
16 meaningful to a lot of us, and so we appreciate
17 those of you who have gathered. I would like to
18 thank the participants in this and our other
19 panels for coming to Washington to have this
20 discussion. Also, our audience in person today
21 and those listening in. We thank you. I'd also
22 like to thank Tracey Wingate from our staff who

1 has worked very hard on this, and Margie Yates and
2 the D.C. logistics staff who have worked very hard
3 to make this run smoothly.

4 So today's topic is an important one, as
5 the Chairman mentioned. Our focus is on the
6 recently released CPMI/IOSCO guidance regarding
7 the PFMIs. There are the international standards
8 for the safety and resilience of CCPs,
9 clearinghouses, in the context of U.S. DCOs. DCO
10 is the CFTC term for derivatives clearing
11 organizations. What others may refer to as
12 clearinghouses, but DCO is a term that will be
13 heard a lot today, and it's a CCP that clears
14 derivatives and has regulatory status under our
15 rules, loosely speaking.

16 So this event is part of the CFTC's
17 continuing efforts to strengthen our DCOs and
18 ensure their resilience. As the Chairman
19 mentioned, a top priority is working with our DCOs
20 to establish robust recovery plans and wind down
21 plans and rules, in many cases, by the end of this
22 year to have those in place.

1 interested in getting your insights as industry
2 leaders, clearinghouses, clearing members,
3 clearing participants, and other stakeholders on
4 the potential impact of the guidance in the
5 context of U.S. DCOs.

6 I'd like to just take a moment to remind
7 everybody of what's at stake with a couple of
8 relevant metrics. There's approximately \$300
9 billion worth of initial margin on our registered
10 DCOs today. So that's a proxy, a very good
11 indicator of the amount of risk that is being
12 managed by our clearinghouses and their importance
13 to our markets and the American and world economy.

14 Of that \$300 billion about two-thirds or
15 \$200 billion represents customer margin, and
16 another \$100 billion represent margin per house
17 for proprietary positions. So, you know, one of
18 the vital interests at stake is the protection of
19 customers and customer assets. That, again, is a
20 measure of the customer investment and what's at
21 stake.

22 In terms of variation margin, the daily

1 settlement of transactions to, again, risk manage
2 these efficiently. Average daily margin over the
3 past year has been approximately \$5.8 billion
4 changing hands every day. Again, a measurement of
5 the importance of risk management in this area.
6 The peak variation margin, around the time of
7 BREXIT, was in the neighborhood of over \$25
8 billion. So these are very significant metrics
9 that indicate the importance of these.

10 As a result of the G-20 reforms
11 clearinghouses are more important than ever and
12 their safety and resilience is critical. Today,
13 we are here to discuss international standards for
14 clearinghouses. The derivatives' market, as we
15 know, is a global market. It's not confined to
16 our borders. It's important that authorities
17 internationally has worked together to develop the
18 PFMI's international standards that CCPs around
19 the world abide by.

20 We've made very good progress on these,
21 but we're not sitting still. That's why a large
22 amount of work has been done to make the PFMI's

1 more granular in these areas to assist the
2 clearinghouses and their risk management. The
3 value of your comments today will help from the
4 thinking and responses to the guidance while it's
5 still being formed. It may also, down the road,
6 influence the thinking of our staff as we may
7 consider whether to incorporate elements of this
8 into our own framework of rules.

9 Conversations like those today promote
10 convergence and identify the issues before things
11 are set in stone. We've seen what happens when
12 there's a divergence in departure from
13 international standards. In one recent example a
14 set of differences with Europe that took four
15 years, an enormous effort on both sides of the
16 Atlantic to resolve until Chairman Massad and
17 Commissioner Hill reached a common approach
18 earlier this year.

19 The common approach avoided market
20 disruption and has now been implemented by both
21 sides. But before that occurred it consumed
22 enormous resources and attention on both sides of

1 the Atlantic that might have otherwise been
2 focused on the safety and resilience of CCPs.

3 I look forward to our discussion today
4 and now turn over to the interminable, Bob
5 Wasserman, our moderator, co-chair of the
6 CPMI/IOSCO policy standing group that developed
7 and issued this consultative guidance. He's also
8 the Chief Counsel of the Division of Clearing and
9 Risk, and also our CBO, our Chief Baking Officer.
10 Now, I'll turn this over to Bob.

11 MS. WASSERMAN: Thank you, Jeff. I'd
12 like to thank Chairman Massad and Jeff for those
13 remarks. I'd also like to introduce my other
14 colleagues here at the table. To Jeff's right is
15 John Lawton, our Deputy Director for Risk
16 Surveillance and Tracey Wingate to my left.

17 As the panelists all know, Tracey bore
18 the laboring in getting today's roundtable set up,
19 and has made this, for me, virtually a turnkey
20 operation. I owe her a great debt of gratitude
21 for her deft and successful efforts. I also
22 appreciate the work of our colleagues in our

1 Office Management Operations who helped get this
2 whole thing physically set up.

3 I'd like to thank you all for coming to
4 Washington to participate in this industry
5 roundtable. I'm particularly grateful to our
6 panelists, representing DCOs, clearing firms, BIFI
7 participants and others for their efforts here
8 today. I should note that industry input has been
9 a invaluable input into the work of the CPMI/IOSCO
10 policy standing group under the CCP work plan that
11 Jeff and the Chairman have referred to, and that
12 includes two workshops that the PSG held in March
13 and May of last year, some very helpful industry
14 papers that fed into the work that became the
15 consultative document, and an international
16 workshop that was held in Basil last week.

17 I'm confident that today's roundtable
18 will be similarly valuable, and crucially, that we
19 are looking forward to the written comments that
20 stakeholders will be submitting to CPMI and IOSCO
21 on October 18. As Jeff noted, today's roundtable
22 is focused on the impact of the guidance in the

1 U.S. context. As CFTC staff participate in the
2 international work, under the supervision of the
3 Commission it is important that we have these
4 domestic impacts in mind.

5 I should note that international
6 standards and guidance respecting those standards
7 are not self-executing legal requirements here in
8 the U.S. Only the Commodity Exchange Act and the
9 Commission's regulations have that status. One
10 may expect that this guidance once finalized in
11 the international context will result in the
12 consideration of guidance, in some cases, with
13 respect to existing Commission regulations, and in
14 some cases may well require some comment rule
15 making.

16 That said, it would seem to be best for
17 all concerned, for a number of reasons, including
18 those that Jeff explained, to help ensure that the
19 international guidance that results from this
20 process is well-developed and fit for purpose. I
21 should note there are a number of what my
22 economist friends would call incentives that would

1 support a result where the CFTC ruleset is
2 consistent with international standards and
3 guidance.

4 It is important to note that the draft
5 guidance focuses on improving work by challenging
6 it. For example, by a CCP's board challenging
7 management, and by clearing members challenging
8 the CCP, or the DCO in our context. Today, and by
9 the written comments on October 18, we hope that
10 you will improve the work of the draft guidance by
11 challenging it. Moreover, today's interaction
12 between stakeholders gives us the opportunity or
13 gives you the opportunity to constructively
14 challenge each other's views, and I very much hope
15 you will grasp that opportunity.

16 That said, we have a lot to discuss and
17 not a lot of time to do so. Please do try and
18 keep your responses to about two minutes or so, so
19 we can have as much opportunity as possible for
20 exchanging views. I also have a couple of
21 administrative announcements.

22 First, to be recognized please put your

1 name tent on its side. Panelists, please press
2 the button to activate the microphone when you
3 speak. I should note that this roundtable is
4 being audio cast to some folks who are calling in,
5 and it is being recorded, and those folks and that
6 recording can only hear what you say if the
7 microphone is on. If you forget to turn it on you
8 may see me pointing at my ear to remind you.

9 On the other hand, please turn your
10 microphone off when you stop speaking as we can
11 only have a limited number of these microphones on
12 at a time. If you use abbreviations or technical
13 terms please do explain on the first time you use
14 them so that folks who are maybe less familiar can
15 understand what you're saying.

16 Real administrative stuff, restrooms are
17 outside the room to your right as you leave, down
18 the corridor, and then ultimately to your left.
19 We have some coffee, tea, and decaf in the back,
20 as well as water. As is traditional, there will
21 be cake. In this case, during the second break
22 after the Panel 2 which will be around quarter of

1 noon. There are lemon and chocolate cakes and
2 they are very fattening. You've been warned.

3 I should note that while my colleagues
4 and I will be asking questions and may express
5 some tentative views, anything any of us says
6 represents, at most, only our personal views and
7 does not represent the views of the staff as a
8 whole or of the Commission. As Jeff mentioned, we
9 will be making a transcript of this roundtable
10 which will be posted on the CFTC website and the
11 video feed will be available eventually on
12 YouTube.

13 Previous videos have accumulated
14 hundreds of views, and I imagine this will as
15 well. So with that, I'd like to get started with
16 our first panel which will be lasting until about
17 10:15. That first panel is on stress testing. So
18 I'm going to throw out a question.

19 The first one is that the guidance
20 provides that the CCP should be conducting
21 distinct but consistent stress tests for credit
22 risk, on the one hand, and liquidity risk, on the

1 other, in accordance with PFMI requirements.
2 These tests need to be structured in a way that is
3 consistent with the rules and procedures that
4 govern how credit liquidity risk is managed on a
5 day-to-day basis and following a participate
6 default. Is the guidance in this area
7 appropriate? Is it sufficiently clear? Who'd
8 like to start?

9 MR. PERKINS: Good morning. Chris
10 Perkins. I'm from Citi and I'm representing the
11 client clearing member perspective. We believe
12 that robust and consistent stress tests are very,
13 very important. However, we are concerned because
14 it's not about the stress test itself. It's about
15 what clearinghouses do with the stresses that they
16 find, and currently we see a great disparity
17 amongst how they allocate the stress.

18 We believe that stresses should be
19 allocated in accordance with the defaulter pays
20 model. Meaning that people that bring the stress
21 into the system should have to collateralized
22 against it. So what means in practical terms is

1 that the initial margin plus the skin in the game
2 should be sufficient enough to mitigate the
3 stresses.

4 The problem that we're seeing is that
5 some CCPs are departing from the traditional
6 waterfall, and rather than focused on allocating
7 these stresses via the traditional waterfall, be
8 it the initial margin, skin in the game guarantee
9 fund and assessments they are allocating to client
10 clearing members these concentration assessments
11 to mitigate the stress.

12 I guess this is a way of saying that we
13 don't think the guidance is prescriptive enough.
14 What it should do is it should clarify that stress
15 is achieved through, hopefully, robust measures
16 are distributed in accordance with the defaulter
17 pays model. If they're allocated directly to
18 client clearing members because of the stresses
19 that clients are bringing into the system bad
20 things happen. Because what it does is it breaks
21 down portability, and we believe that portability
22 is incredibly important during a time of stress

1 because it allows the system to dynamically
2 rebalance.

3 So, again, we believe in the traditional
4 waterfall. We believe in the defaulter pays
5 model. We believe in robust and consistent
6 stresses. If a CCP wants to go over and above and
7 be more robust that's their prerogative. However,
8 they need to allocate those stresses in accordance
9 with the defaulter pays model. Thanks.

10 MR. WASSERMAN: Dale?

11 MR. MICHAELS: Hi. Dale Michaels, the
12 Options Clearing Corporation. We're good with the
13 guidance that there should be some connectedness
14 between the credit and liquidity stress test.
15 There are a couple points that we would like to
16 point out that seem to be inconsistent with
17 extreme but plausible type of stress testing that
18 might drive guarantee fund.

19 One in particular, there's some mention
20 of unsynchronized stress test scenarios. What
21 that means is that you could come up with an
22 extremely implausible type of situation. So, for

1 example, if you went to the 1987 stock market
2 crash, you look at a coupled date move. That's
3 around 30 percent. If you take that on the
4 downside from the start, and then also look on the
5 upside you're not only looking at a 30 percent
6 down move. You'd be looking at about an 85
7 percent up move from that 30 percent down move.
8 Taking in a very small segment of time would be, I
9 would argue, extreme but implausible type of
10 stress testing scenario.

11 So it should be taken into account with
12 the governance that is around the CCP. We are for
13 transparency. There should be a good governing
14 body. It should be approved by the respective
15 board, the risk committee, and it should be
16 transparent to the firms. We are a believer of
17 transparent stress testing in the scenarios and
18 the governance around so that the clearing
19 members, the buy side know that the stresses that
20 the CCPs are doing and could better manage their
21 books.

22 As far as concentration stresses, I also

1 am a believer of the defaulter pays model as well.
2 But I do want to point out the unsynchronized
3 scenarios and we'll be likely getting some
4 comments on that piece.

5 MR. WASSERMAN: Let me press you for a
6 moment on that now.

7 MR. MICHAELS: Sure.

8 MR. WASSERMAN: So I understand, from
9 what you're saying, there are clearly cases where
10 unsynchronized stress testing would lead to
11 extreme and implausible. Is there room for more
12 targeted guidance around unsynchronized stress
13 testing? Is it useful in any context or is
14 something that just simply doesn't work?

15 MR. MICHAELS: It would be hard to come
16 up with a one-size fits all type of approach that
17 could fit all of our different products. We have
18 a myriad of different products that are
19 represented here in the U.S., as far as the
20 options, the commodity products and come up with
21 the one-size fits all, try to get that
22 prescriptive on an unsynchronized scenario when

1 we support the views on that as well. But one of
2 the things to keep in mind, I think, when we talk
3 about stress testing is also pro-cyclicality. So
4 what we noticed in the guidance, you know, there
5 are two aspects to this guidance. One is on
6 margins and one is on stress testing.

7 So when we look at margin there's been a
8 lot of focus on pro-cyclicality and
9 anti-pro-cyclicality measures to take in debt
10 around anti-pro-cyclicality. But when you look at
11 the guidance on stress testing we were surprised
12 to find -- bear in mind that we support the goals
13 of the effort. You know, we want a robust
14 framework from a stress testing perspective and
15 from a margining perspective.

16 But when you look at some of the
17 guidance, or I would call them prescriptions that
18 are out there. They seem to be very extremely
19 pro-cyclical. So let me just give you some
20 examples. One is automatic triggers or thresholds
21 for collection or coverage of exposures on a
22 same-day basis. That implies that if there are

1 certain things that would take place. Bear in
2 mind it's in conjunction with another aspect of
3 the guidance which talks about intraday changes
4 and positions, and intraday peak-to-trough
5 movement in prices.

6 So if you take that all into account and
7 you look at what happened on June 24, you know,
8 there were a lot of positions that were changing
9 dynamically. Market participants are reacting to
10 the events that took place. There is a specific
11 exogenous event which is the referendum result
12 itself, and then there are markets that are moving
13 dynamically all the way from Asia time zone to the
14 European time zone to the U.S. time zone. So the
15 positions are dramatically changing.

16 So if you have a mechanism or as
17 prescribed an automatic trigger for collecting
18 exposures than what you end up doing is you end up
19 sucking a lot of liquidity. You threw out a
20 number that says 20 billion that was collected on
21 that day from a VM perspective. I don't know if
22 all of that is VM. There are different ways of

1 looking at things and I think in the next panel
2 Chris may talk a little bit about experiences that
3 firms had on that day.

4 But you end up being extremely
5 pro-cyclical, sucking a lot of liquidity in the
6 system. Our question is, isn't that pro-cyclical,
7 right? So in a sense you are putting extreme
8 strain on your clearing member and client
9 community exactly at the same time when liquidity
10 is dear. So the question we have to ask ourselves
11 is, what exposures are recovering?

12 There is a lot of margin on deposit. We
13 have prefunded resources to cover the risk. Risk
14 teams, and I'm sure this is true of every CCP,
15 have real time systems that monitor exposures of
16 our clearing firms on a real time basis relative
17 to the cover that we have. Okay? But to expect
18 these automatic triggers is, I think, extremely
19 pro-cyclical. We feel that we should go back to
20 the goals of stress testing. What are we trying
21 to really cover?

22 If we are trying to cover extreme and

1 plausible circumstances we are going back in time.
2 You know, we can look at those and see where there
3 are gaps in terms of that and the stated goals of
4 the purposes of stress testing. Then the idea is
5 to make sure that we use a combination of tools.
6 Margin is one of them. That's how you come up
7 with shortfalls. Then the rest is uncovered tail
8 losses that have been neutralized.

9 So, Chris is right. When you end up in
10 a structure where you start going on a gross basis
11 and you start collecting stresses and you only
12 account for losses, and you start sucking this
13 from the system. Then you actually create an
14 extreme strain on, especially, client clearing
15 members. So I will yield my time, but I just
16 wanted to make that point.

17 MR. WASSERMAN: So let me just clarify
18 where we're going here because, at the moment, you
19 know, given the focus at the moment on stress
20 testing which you're conducting during peace time
21 before the stress events happen. Does more, you
22 know, detailed, rigorous stress testing help

1 alleviate the concerns that you're raising
2 because, essentially, you're participating all of
3 those things that can go wrong and essentially
4 prefunding them, again, during peace time or is
5 this something to how we should be doing that
6 stress testing during peace time?

7 MR. CUTINHO: No. That is where some of
8 it departs from stress testing. I don't know if
9 this was intended or unintended in the
10 prescription, but the anchoring to changing
11 positions throughout the day that's a part of
12 stress testing. You know? It's not a part of any
13 other section of the guidance. It's a part of
14 stress testing.

15 Anchoring to intraday movement in prices
16 is also a part of stress testing. So this is why
17 I'm bringing it up within the context of stress
18 testing. We think that that guidance is, you
19 know, not consistent with the role of stress
20 testing which is supposed to be a set of funds
21 that are available to cover extreme stressful
22 scenarios.

1 If the concern is that at a point in
2 default, right? You need to make sure that, you
3 know, the resources that you have are good to
4 cover the risk exposures that you're dealing with.
5 Then you have to look at the time at which CCP
6 settle with market participants. That's when
7 somebody's supposed to pay you. The point in time
8 they have exposures. Then, you know, CCP runs
9 margins at that same time to cover those exposures
10 and collect those margins.

11 So the focus to intraday changes and
12 positions, I don't know where the prescriptions
13 are going. But the guidance doesn't seem to be
14 very clear. But it tries to imply, if you read it
15 for what it is written, it tries to imply that
16 stress testing or stress calculations have to be
17 anchored to intraday changes in positions. So
18 that is the concern I'm raising.

19 MR. WASSERMAN: Great. I've got Chris
20 and then I've got John and then Li, I believe it
21 is.

22 MR. PERKINS: Just very quickly to echo

1 what Sunil said. It's been years since we've been
2 in such violent agreement. The bottom line is
3 that stresses should result in a well-calibrated
4 waterfall. That standing waterfall, to his point,
5 is what needs to stand and protect us during times
6 of stress.

7 As he discussed, if there's a period of
8 time where there is a stress and a CCP starts
9 calling intraday over and over and over again you
10 have pro-cyclical impacts take effect. What it
11 results in is a liquidity race to the bottom.
12 Because if one CCP starts calling the other one is
13 there sitting back on its waterfall there's going
14 to be an underlying race for liquidity. And so we
15 are, again, supporters of robust standing
16 waterfalls.

17 Rather than think of it like driving a
18 truck over potholes without any shocks. That's
19 what's happening when you're going through these
20 intraday thresholds. It's very, very stressful,
21 challenging, and dangerous in a liquidity
22 perspective.

1 MR. DABBS: Yes. The only point I'd
2 just like to bring up is that the interconnected
3 nature of the market for the CCPs in general, and
4 when we talk about stress test I think we also
5 need incentives to ensure that when we run the
6 stress tests from a market's perspective that we
7 don't assume that the same liquidity provider that
8 we have assumed in the stress test is no longer
9 there. That they're still providing liquidity.

10 So I think we need to have incentives to
11 ensure that we don't have -- the largest member
12 isn't also the largest liquidity provider from a
13 repo line perspective or from any sort of funding,
14 and from a custody perspective. So I think that
15 it needs to be looked at through the entire chain
16 as opposed to just the stresses individually, and
17 then liquidity sources being independent.

18 MR. WASSERMAN: Okay. That's fair.
19 I've got Li, Marnie, Bill, Dale, and then Sunil
20 again. If I've gotten your name wrong I
21 apologize. Sorry.

22 MR. WANG: Liping from Barclays. I

1 would just say that the pro-cyclicality, it's a
2 valid point. I think we probably should
3 differentiate between two kinds of pro-
4 cyclicality. I'm sure we understand. Either you
5 hold the position steady and then the market goes
6 into a (inaudible). The margin will increase. So
7 that kind of present you cannot control.

8 But the other part is that you could
9 suddenly increase the position. That, at least,
10 the position taker you have some control there. I
11 don't think the (inaudible) should cover that. So
12 that's one point.

13 The second point is that, yes,
14 liquidity, managing that stressor is very
15 important. But let's suppose, for example, if the
16 margin increases, just for the sake of discussion
17 let's say increases \$30. We have a cap that you
18 cannot increase more than \$20. So you have that
19 \$10, you see, I cannot call for that. So what
20 that means is that you will violate your
21 defaulters pay first. So that's one.

22 The other one is that under covering

1 will be shared, essentially, through the waterfall
2 by other members. So, essentially, other members
3 would take that kind of, if you will, risk there.
4 So the point we are taking, I know in the margins
5 that we could (inaudible). We probably have to
6 balance between will the default pay first or
7 whether other members should share that versus the
8 liquidity strains that you have to call during the
9 stress period. Thanks.

10 MR. WASSERMAN: Marnie?

11 MS. ROSENBERG: Thank you, Bob and Jeff
12 and Tracey and John for inviting me here today.
13 I'm Marnie Rosenberg from J.P. Morgan. I'm
14 speaking on behalf of, obviously J.P. Morgan, but
15 I manage clearinghouses risks. So my remarks are
16 coming from a safety and soundness and a risk
17 perspective, and our firm's ability to measure and
18 manage our risk.

19 So, first of all, I'll say what I said
20 at the CPMI/IOSCO roundtable last week which I
21 think the guidance, the proposed guidance on
22 stress testing is excellent. I think it's

1 comprehensive. I think you guys, you know, Bob,
2 kudos to you and Danielle LaRuso. You did a
3 really good job pulling this together. It's
4 obvious you took a lot of recommendations through
5 the (inaudible), so we appreciate that.

6 The first comment. I want to respond to
7 Dale and Sunil on the use of unsynchronized stress
8 tests. I completely respect what both of you said
9 in the specifics related to the clearinghouses
10 that you run. When I look at the global, kind of
11 from a global perspective, which is my
12 responsibility, we see, you know, differences in
13 structures in terms of the period of risk that we
14 have to member defaults. And we see diversified
15 asset classes within a given clearinghouse or
16 clearing segment.

17 So I would be careful in terms of, you
18 know, suggesting that use of unsynchronized stress
19 test does not apply universally because, I think
20 actually, there are instances where unsynchronized
21 stress tests would be very important in some
22 clearinghouses that I can think of in other

1 markets. So I just wanted to make that point.

2 Back to, Bob, your original question on
3 the consistency of credit and liquidity stress
4 testing. There are just a few comments I want to
5 make. You know, a default event, a member default
6 where there's credit losses would definitely be
7 associated with related liquidity demands. We all
8 know that. However, there can be a liquidity
9 event which is unrelated to a credit event.

10 Therefore, so whether it's in terms of
11 coverage standard and related stress scenarios or
12 in terms of application at segment versus a CCP
13 level, assumptions for credit risk should set the
14 minimum for liquidity risk. We don't think you
15 can talk about stress scenarios without talking
16 about coverage. I also said this last week which
17 is there's a perception. I would say that there
18 is a universal cover to standard for credit and
19 liquidity losses. That's actually not the case.

20 It is the case under AMIR and it is the
21 case for U.S. SIDCOs, and those, obviously, that
22 opt into the U.S. SIDCO rules. We do believe

1 there should be a universal cover two standard.
2 So from a stress testing perspective and an
3 overall coverage perspective we believe that
4 should be the minimum. However, there should be
5 responsibility placed on clearinghouses to assess
6 whether given the distribution of risk and
7 uncollateralized stress losses among the membership
8 it would make sense to cover more than two.
9 Meaning that if there's more of an equal
10 distribution of risk, perhaps, it shouldn't just
11 be cover two. That may not protect the
12 clearinghouse universally.

13 Then the consistency between credit and
14 liquidity risk management, CCP versus a segment
15 level. Similar to the consistency in coverage,
16 there should also be consistency in how liquidity
17 risk is managed. Where CCP manages credit risk at
18 a segment level there's a limited rationale to
19 manage liquidity risk or recourses at a CCP level
20 on a shared basis. That's the first point I would
21 make.

22 Even where CCPs manage liquidity at a

1 shared level, CCPs should be attentive to the
2 challenges associated with modeling stress areas
3 across multiple asset classes. And, importantly,
4 when CCPs have the ability to borrow cash
5 collateral from non-defaulting members, which many
6 do, they should be required to replace these with
7 forms of security collateral and bear the market
8 risk that's associated with that. Clearinghouses
9 should also have responsibility for returning cash
10 collateral and be made liable for this market
11 risk. Thank you.

12 MR. WASSERMAN: Thank you. Bill?

13 MR. THUM: So first of all, thank you
14 for inviting me here today to speak. I'm here on
15 behalf of Vanguard and our 9 million investors.
16 We use derivatives, as I've said many times
17 before, principally to hedge the risks that are
18 presented in the portfolios, to invest
19 efficiently, and to manage cash positions.

20 We've been very involved with regulators
21 over the past few years to help craft the new
22 architecture for derivatives' trading to make sure

1 that it is transparent and stable, and protective
2 of our client assets. You know, coming here today
3 to talk about stress testing, in particular, you
4 know, we look at it from a perspective of being
5 fiduciaries for those assets. Given that there is
6 now a mandate to clear our trades with the
7 clearinghouses rather than trade over the counter
8 and settle bilaterally we're very focused on
9 having transparency in our decision making in
10 terms of our selection of clearinghouses, our
11 select of clearing members.

12 We have a very robust process presently
13 and review of our clearinghouses, and we have
14 great confidence in them. But we are aware that
15 the information is not easily available or
16 transparent. So in looking at the consultative
17 report I'd like to echo the comments that have
18 been made that it is an excellent framework to
19 strengthen both the issues of stress testing and
20 disclosure related to stress testing. We feel
21 there should be public disclosure of benchmarking
22 tests, and the tests should cover both credit and

1 liquidity risks using both historical and forward
2 looking models.

3 In terms of additions or improvements to
4 the consultative report, comments letters that
5 we'll be involved in we'll be recommending that.
6 The disclosures should be accurate with penalties
7 for misstatements. The disclosures of the results
8 of stress testing should be available on a central
9 website, and the disclosures should be sufficient
10 to allow informed decision making in selections of
11 clearinghouses.

12 We agree that the test should include
13 potential sources of liquidity risk and should
14 also address infrastructure failures such as
15 custodian risk. The test should ignore voluntary
16 excess contributions that may be withdrawn, and we
17 also don't feel the test should assume that trades
18 will port given the complexities of porting trades
19 in market stress.

20 In terms of looking at enhanced aspects
21 of the test, we're focusing on the
22 interrelationship between clearinghouses, clearing

1 members, the products that are traded across
2 clearinghouses, and the risk that potentially can
3 arise when a market participant defaults to a
4 clearing member. The market participant that may
5 clear across various clearing members and in
6 various clearinghouses, and the cascading risks
7 that can therefore arise due to this connection,
8 the interconnectedness between the participants,
9 the clearing members, and the clearinghouses. We
10 agree with the consultative report that this
11 interrelationship should also be recognized in the
12 stress testing.

13 MR. WASSERMAN: Dale?

14 MR. MICHAELS: One point back on the
15 intraday, to echo part of Sunil's statement is the
16 intraday positions are, by the very nature,
17 transitory. So when we're doing stress testing
18 from a CCP we can look at end of day positions.
19 We can allocate that based on knowing what the end
20 of day risks are. When we're looking at intraday
21 positions which are transitory.

22 You have give ups that are happening,

1 other types of business where to do that it would
2 be a hypothetical, so then we would be doing a
3 hypothetical of a stress test of not real
4 positions, and then would be allocating to the
5 clearing fund based on that hypothetical. So you
6 have a hypothetical stress test on a hypothetical
7 position. It's not necessarily where -- gets you
8 to the transparency that you want to be.

9 The other point I'd like to make on
10 cover two, cover two liquidity. Understanding
11 that there is a European standard on cover two
12 liquidity, but I'd also like to point out that
13 there are differences underneath there. So when
14 you look at a cover two liquidity standard in
15 Europe they have the practice of being able to use
16 cash collateral from non-defaulters' margin, so
17 non-defaulters' margin could be used as liquidity
18 source for a default. A much different practice
19 than what you see here in the U.S. and the CCPs.

20 So before we start going and say, cover
21 two for everything, and leave it at that we have
22 to look at the underlying details of what that

1 really means, and figure out what is the practice
2 of each of the markets, and make sure that we're
3 consistent across there.

4 MR. WASSERMAN: Let me press you just
5 for a moment though on the intraday point.
6 Because you mention the concept of, you know,
7 hypothetical positions and speaking for myself,
8 until I'm told to change my views, I can certainly
9 see a lot of the difficulties around that. On the
10 other hand, I also get concerns and hear concerns
11 from others around, you know, the fact that you
12 never know when a default is going to happen.

13 An entity which intends on being flat at
14 the end of the day could on the day, you know, on
15 the day of its demise not succeed in that. So in
16 other words, you're not guaranteed that the
17 exposures you see intraday won't be reflected in a
18 default or are you? Is there room, in other
19 words, for something somewhere in the middle here
20 to take into account, somehow, things that are
21 happening intraday to the extent they are
22 plausible? Are they ever plausible?

1 MR. MICHAELS: So a couple points on
2 that. An intraday, I think, just by looking at
3 stress testing we're discounting the fact that
4 there's other CCPs here have real time intraday
5 risk. We're looking at the positions. We have
6 staff that are looking at the risk that are
7 following up with the clearing member firms, that
8 are doing the analytics, that are looking at an
9 ensuring that the risks that are taken on by each
10 of the clearing members or the buy sides
11 underneath the clearing members are appropriate.

12 So to look at just intraday stress test
13 and have that be the panacea and say, well, we're
14 going to have that. That ignores everything else
15 that the CCPs do on their day- to-day risk
16 management. So I think that's something that
17 needs to be considered.

18 The other point is when you look at
19 intraday it's not necessarily looking at the
20 default management process. It's not necessarily
21 the case where we have a default that happens
22 intraday when someone just takes on a position.

1 What happens is those positions might be taken on.
2 They go to the settlement cycle and in the next
3 morning the settlement bank says no. This is too
4 much. That's when the default process starts.
5 It's not exactly it took up positions and they
6 defaulted and they start doing it at intraday.

7 So when you start looking at intraday
8 prices, intraday positions it's ignoring the fact
9 that a lot of this is more of the end of day type
10 of stuff when you get to settlement banks and then
11 you start your default measured process at that
12 time.

13 MR. WASSERMAN: I've got Sunil and then
14 Sebastian.

15 MR. CUTINHO: I will address a few
16 points, you know, in the following order. I think
17 I'll start with liquidity, just following up on a
18 few things that Dale pointed out. Client porting
19 and spend some time on disclosure, and finally
20 infrastructure failures.

21 So starting with liquidity, you know,
22 just to add to what Dale is saying, you know, and

1 also touching on one of the points Marnie made.
2 You cannot simply take cash, you know, although
3 there are regulatory jurisdictions. There's
4 differences in one place, that is true, but you
5 cannot simply take cash that the clients post as a
6 liquidity resources without taking into account
7 what kind of a stress you're imposing on them.
8 Right? And you cannot simply

9 (inaudible) as a free source.
10 Giving you an example. There are
11 structures in
12 place where CCPs do look to their
13 membership and the cash that they post in
14 guarantee fund as a liquidity resource in certain
15 situations. Let's say we'll call it a liquidity
16 event. Even there they take great care to make
17 sure that those entities have access to convert
18 their securities to cash so they have easy access
19 to liquidity.

20 But trying to come up with a standard
21 and then assuming that a CCP can use any clients'
22 cash is actually very -- it can increase systemic

1 risk because think about it. You know, the client
2 can have needs for their cash for things outside
3 the CCP, for risks outside the CCP for which they
4 may want to draw down the cash. So when clients
5 post cash with us or clearing members post cash
6 with us they also, as margin, they have -- there
7 is a certain level of expectation that comes with
8 that. For those entities that don't have access
9 to liquidity facilities they may want to actually
10 draw down that cash for their other needs outside
11 the CCP. So tying that up or taking that away can
12 impose a liquidity strain on them, so it's
13 important to take that into account.

14 The other thing to remember about
15 liquidity is we've got to go back to the goals of
16 liquidity and the liquidity stress testing. This
17 is a point in time, exercise, at different
18 settlement times. I do agree with the model that
19 you need to have distinct liquidity stress tests.
20 They need to be based on, you know, they need to
21 be consistent with a credit stress test, credit
22 stress testing scenarios so in order to understand

1 the needs.

2 I completely appreciate that
3 perspective, but one of the things we have to keep
4 in mind is it's a point in time exercise. So at a
5 given settlement time what are the needs So
6 simply coming up with a covers two standard and
7 then assuming that we can use everybody's cash
8 available is not -- I mean, those resources are
9 not always available.

10 The second thing to keep in mind is when
11 we are putting these standards we also have to
12 take into account what banking regulators are
13 doing for the banking system as a whole. One is,
14 you know, banks are being penalized for providing
15 liquidity facilities in some sense. They have
16 liquidity coverage ratio. You have net stable
17 funding ratio.

18 At the same time, there are questions on
19 what is high quality liquid assets. So in a
20 sense, people are questioning if treasuries are
21 liquid. So imagine you're trying to create an
22 artificial liquidity squeeze by taking away the

1 normal providers of liquidity because they don't
2 have any incentive to provide liquidity. And at
3 the same time, you're not -- you know, you're not
4 making high quality liquid assets which have a
5 very reliable market.

6 You're saying that institutions cannot
7 use that as a liquidity resource in their
8 measurement of what is considered liquidity. So I
9 think that is something you have to keep in mind.
10 We cannot look at these CPMI/IOSCO guidelines in
11 isolation. You have to take the whole picture
12 into account.

13 Client porting. You know, this, I
14 think, is a jurisdictional thing. You have to
15 take into account the structure of the
16 jurisdiction. In some jurisdictions there is net
17 margining. In a net margining scenario and in a
18 scenario where the jurisdiction imposes that you
19 cannot port clients until you get their explicit
20 consent then I completely sympathize and agree
21 with the fact that you cannot port clients.
22 Right?

1 So in those scenarios porting becomes
2 less probably. In the U.S. you have a structure
3 where, you know, you have a gross margining
4 system. On top of that, we have a negative
5 consent process that allows clients to be ported
6 (inaudible). We have done this
7 empirically. So assuming that all
8 clients would default in stress
9 testing is an implausible standard,
10 so that is what some are asking us
11 to do.

12 Imagine, assuming that all clients of a
13 clearing member are going to default. That is the
14 assumption that the guideline is presuming, but
15 you need to take into account that not all clients
16 can default. If you were to assume that all
17 clients would default why would they just default
18 to one clearing member? They would default to
19 every clearing member. So that doesn't add up.

20 So if the question is about porting of
21 clients then you have to take into account what
22 structure does the CCP operate under, okay? And

1 what jurisdiction?

2 On disclosure, we completely appreciate
3 and support the points in the need to understand
4 risk exposures. So we have disclosures out there
5 right now, quantitative disclosures out there
6 right now. The thing that we have to balance in
7 terms of disclosures, especially concerning
8 results, is that we have to maintain
9 confidentiality of the very same clients and the
10 very same clearing members. You have to draw that
11 balance, so you cannot create harm through
12 disclosures. Perhaps, we need to work together to
13 come up with a mechanism where you can, you know,
14 support a disclosure framework without actually
15 disclosing the risks of clearing firms and
16 clients.

17 Finally, I'm sorry for being too long.
18 Infrastructure failures. I think a CCPs role is
19 in terms of guaranteeing the performance, okay, of
20 -- you know, in terms of credit risk and we talked
21 about liquidity risk as well. But the CCPs role
22 is not to guarantee all the service providers.

1 Imagine a clearing member and a client. They have
2 a relationship. They use a custodian.

3 The few things that have happened
4 recently, clearing members do not guarantee CCPs
5 performance to the clients. They have stopped
6 doing that. Clearing members do not guarantee
7 their custodian's performance to the client. So
8 if something happens to the custodian, you know,
9 between a clearing firm and a client a clearing
10 member doesn't guarantee that. You know?

11 In some cases, if you think about these
12 infrastructures, you know, some of them are
13 systemic infrastructures. They need to have -- in
14 the U.S. we're doing that through the continuity
15 process or the living will process to make sure
16 that some of these infrastructure maintain
17 continuity of access. I think, you know, we have
18 trouble with CCPs and stress testing having to
19 cover all infrastructure failures.

20 MR. WASSERMAN: I would just make two
21 notes. First is that I think the idea is that
22 stress test needs to be, basically, bound to the

1 reality. We may not like the reality, indeed, in
2 some cases you and I may have common cause in
3 having problems with certain realities, including
4 in terms of things like bank capital. But the
5 issue is, I think, is that the stress test needs
6 to be bound by that reality, whatever it might be.

7 The other observation I would just very
8 quickly make is in terms of client porting. I
9 think what the guidance is saying is not assuming
10 that all clients default, but rather that the
11 clearinghouse will not be getting any of the money
12 from the clearing member. In light of porting
13 taking a couple of days as it did, for instance,
14 in MF Global in light of clearing members finding
15 themselves in 10 years of litigation for failing
16 to stop payments that were made upstream, as in
17 the case of the Griffin brothers. It's not
18 entirely clear to me how implausible it is that
19 you won't be seeing any more money from a clearing
20 member regardless of whether the clients
21 themselves default to that clearing member.

22 I've got Sebastian, Stephen, Marnie,

1 Nicolas, and Bill. So, Sebastian?

2 MR. RENARD: Yes, good morning. Thank
3 you for the invitation to this panel. I would
4 like to echo in support the comments with respect
5 to transparency to the clearing members to the
6 stress test results. We believe that under the
7 current states there is little stress test
8 transparency outside of the risk committee
9 context. Sometimes also limited in that context.

10 So clearing members are essentially
11 required to rely on CCP assurances that they
12 maintain sufficient resources. So we believe that
13 clearing members should receive better disclosure
14 beyond the risk committee level, both regarding
15 stress testing scenarios and the ultimate results.
16 So we therefore recommend access to CCP stress
17 test results so that clearing members can
18 appropriately assess the credit and liquidity
19 coverage. Thank you.

20 MR. WASSERMAN: Stephen?

21 MR. BERGER: I want to comment on a few
22 of the topics that were raised. First on the

1 intraday issue, Bob, I'm sympathetic to your point
2 that, you know, at any point in the day the music
3 could stop. So, just trying to think of the right
4 analogy to use here. So I was thinking of a game
5 of musical chairs, and so I think the point is
6 that, yes, the music can stop at any point. We
7 just want to make sure we have enough chairs
8 there, and it's not like the game is being played
9 in school where one of the chairs has been pulled
10 away.

11 So I think about that in context of how
12 we appropriately design the stress test. I think
13 the two, at least two of the thoughts on a
14 intraday basis are, you know, what positions are
15 there at any point in time that may differ from
16 what positions are there, typically, at the end of
17 the day. And then are there intraday price moves
18 that have occurred historically that aren't
19 observed when we look at end of the day prices.

20 I'll caveat that by saying that there,
21 at times, erroneous intraday price moves that we
22 would not want to use. But for designing stress

1 tests it does seem reasonable me that you could
2 design a stress test that would look at certain
3 intraday changes that have happened historically
4 that may not be observed at the end of the day,
5 but are still worth running a stress test about.

6 I just think that's a different
7 conversation than what's the remedy. You learn
8 something from running that stress test, but the
9 logical conclusion of that is not necessarily that
10 we need to start doing extra intraday settlement
11 cycles as a result of that. So it's more what did
12 we learn from running the stress scenario, and did
13 we prove or not prove that we had enough chairs in
14 place when that music did stop, were it to stop in
15 that kind of setup at the end of the day. So, I
16 don't know, that's the lens through which I was
17 looking at the intraday question.

18 Then, I guess, just two other quick
19 comments on some points that were raised. I
20 think, you know, when we design these stress test
21 scenarios it's readily acknowledged that, you
22 know, the more sophisticated ones are multi-

1 variate in nature and assume certain
2 inter-dependencies. So I think it was a point
3 Sunil might have been raising, but, you know, we
4 can't ignore the fact that there are, you know, in
5 crisis scenarios certain things that are, you
6 know, happen that ameliorate the situation.

7 So if in all the scenarios we look at
8 there's a flight to quality in terms of high
9 quality liquid assets, and those tend to go up in
10 value I don't think we should have all our stress
11 test scenarios necessarily assume that the value
12 of the collateral is plunging at the same time
13 that there are other stresses occurring.

14 Lastly, I just think that discussion you
15 just had about whether or not we assume or not
16 assume the client, you know, the non-defaulting
17 clients of a defaulting clearing member continue
18 to make good on their variation margin payments or
19 not. In light of the, you know, numbers that Jeff
20 cited at the beginning in terms of 200 billion out
21 of the 300 billion in outstanding IM being, you
22 know, reflecting client positions, I can only

1 assume how much of the daily VM flows are
2 client-driven as opposed to direct clearing member
3 driven.

4 I guess it either puts the final point
5 on that we need a better system to make sure that
6 those client VM flows can continue even during a,
7 you know, clearing member default. So I don't
8 know that that's necessarily part of this
9 guidance, but certainly it -- given the relative
10 importance of the client IM and VM pools I think
11 we need to ensure that there's a way to make sure
12 that those monies continue to flow to and from the
13 CCP even in a clearing members' default scenario
14 if that's going to be that material in terms of
15 their kind of, essentially, liquidity to contain a
16 function in that scenario.

17 MR. WASSERMAN: Thank you. Marnie?

18 MS. ROSENBERG: Thank you, Bob. First I
19 just wanted to go on record to clarify what I said
20 about the use of cash initial margin belonging to
21 the non-defaulters. I am not endorsing or
22 recommending that. I'm suggesting that that is a

1 very common practice when I look at our portfolio
2 globally. That clearinghouses in other
3 jurisdictions are permitted to use that cash
4 collateral, and they're not required to designate
5 securities and cover that market risk.

6 And so what I'm suggesting is if that
7 becomes a liquidity source then that needs to be
8 properly managed. We, as clearing members, need
9 to be properly protected from that market risk.

10 The couple other comments I would make
11 with what others have said. I think John made a
12 comment about the reliance on liquidity
13 facilities. I would just say, you know, given the
14 significant interconnectedness between liquidity
15 providers and members we do believe the guidance
16 should set thresholds on the extent to which a
17 clearinghouse can rely on credit lines from
18 members considered in aggregate. That's a really
19 important point.

20 The other additional point I wanted to
21 make was in response to some of the comments that
22 have been made on transparency. You know, what we

1 need to do as a firm is understand what our
2 potential loss is on our guarantee fund and
3 assessments over a period of time. So we do
4 support the proposed disclosures that are in the
5 annex that suggest on an anonymized basis, a
6 distribution of uncollateralized stress losses.

7 If we don't have insight into what the
8 risk distribution looks like it's very hard for us
9 to be able to manage and measure that risk. This,
10 by us being able to do that and all the other
11 clearing members here that will make the system
12 safer. So I just want to make sure that's clear.

13 The other thing that we thought the
14 guidance, there could be more prescription
15 guidance around is the definition of extreme but
16 plausible. We're still kind of challenged by what
17 that means and what risk tolerance mean. I think
18 providing some examples would be really helpful in
19 this way.

20 Then finally, I would just say, you
21 know, in reading through the section several times
22 as I have, I think one thing that is not very

1 clear or missing is what's done with the stress
2 test results. So, you know, clearinghouses,
3 obviously, can run these models and get the
4 results, but it's really about the interpretation
5 of the results and what they do with them. So we
6 believe that clearinghouses should analyze and
7 ensure that the complexity of the results is
8 well-understood, and not just, obviously,
9 unilaterally applied.

10 Also, in understanding the drivers and
11 relationships within the data sets to ensure
12 reasonableness and ensure an appropriate level of
13 conservatism and sizing the safeguards. Thanks.

14 MR. WASSERMAN: Thank you. I've got
15 Nicolas, Bill. Andre, I don't know if you still
16 wanted the floor?

17 MR. FERNANDEZ: No.

18 MR. WASSERMAN: Okay. Then Jacob, Dale,
19 and Eileen. So, Nicolas. I will apologize to
20 everyone if I mispronounce your name or garble it
21 in any way. Please correct me.

22 MR. FRIEDMAN: That's okay. You can

1 call me Nico. Nico Friedman from Goldman. Just
2 want to make a couple of points. So generally we
3 are very pleased with the guidance. I think it's
4 been comprehensive, particularly around the
5 identifications of the various risks that should
6 be considered through stress testing.

7 It is probably daunting to think about
8 the actual implementations, particularly as we get
9 more granular, but that's probably the cost that,
10 you know, we're going to have to incur to make
11 sure that, you know, CCPs never get to the point
12 of non-viability which, I think, everyone in this
13 room would agree with.

14 The topic of stress testing, credit
15 stress testing, liquidity stress testing, are
16 extremely complex. So from a transparency
17 perspective, certainly as clearing members, we
18 would want to have the tools to better understand
19 our potential risk exposures and manage
20 accordingly. But there's another dimension which
21 is the market confidence.

22 So even if, you know, you cannot

1 necessarily get to the level of disclosure that we
2 would want because of confidentiality reasons or
3 other aspects just disclosing to the broader
4 markets some of the stress testing shocks, ad hoc
5 scenarios, how CCPs try to anticipate macro events
6 that are out there, and just give the broader
7 confidence to the market that, you know, the
8 resources are sized to whether this kind of
9 scenarios, I believe are going to be very
10 important from a systemic risk perspective.

11 Just a couple of points on credit risk
12 and liquidity risk, stress testing. On credit, I
13 would generally agree with the point Marnie made
14 that there's a lack of consistency as we go
15 through CCPs globally in terms of definition of
16 extreme but plausible. Some of the actual risk
17 factors are being assumed to size the funded
18 resources. A stress period of risk which is
19 mentioned in the guidance which is extremely
20 important maybe could benefit from being a bit
21 more prescriptive, especially as we think about
22 the liquidity of certain portfolios or certainly

1 thinking about two large members defaulting at
2 once. You know?

3 In terms of the concentration of the
4 positions associated with that, as well as to the
5 extent there are products where liquidity could
6 drop in terms of stress how do CCPs actually think
7 about incorporating that into stress testing
8 measures. I think that's important.

9 Finally, on liquidity, I would also
10 agree that in terms of thinking about the right
11 stress scenarios you probably need to look beyond
12 just the credit defaults or defaults of largest
13 members. Certainly thinking about a concurrent
14 (inaudible) in, you know, financing markets, repo
15 markets, operational failures that could be in,
16 you know, from a marketing infrastructure
17 perspective or through members having issues at
18 the same time. That should be considered.

19 Finally, I think there was a point made
20 as well. The guidance should highlight the need
21 to look beyond clearing members for liquidity
22 because surely a wrong

1 (inaudible) risk aspect here is
2 very concerning.

3 MR. WASSERMAN: So I've got Bill DeLeon,
4 Jacob, Dale, Eileen, Bill Thum, and I think Bill
5 is going to have the last word because then we're
6 going to come to the end of this session. So Bill
7 DeLeon?

8 MR. DELEON: Bill DeLeon, PIMCO. Thank
9 you, again, for the opportunity to come and speak
10 today. Good seeing you all again. This time on a
11 different coast in a different country.

12 A couple of comments. First of all, in
13 terms of stress testing, while we understand the
14 need and desire to have public information we're
15 not fully convinced that it is truly necessary to
16 have it public. We do understand the need for
17 stress testing to be conducted by CCPs.

18 However, our view is that if it becomes
19 a requirement to become public we run the risk
20 that prescriptive stress testing will sort of
21 muddle information because different CCPs and
22 different silos require different tests and have

1 different market conditions. You'll constantly be
2 chasing your tail trying to get meaningful
3 information. It's going to be a difficult
4 problem.

5 Our concern is, though, that there be
6 mandated tasks that meet some standard and that
7 the CCPs need to attest that they meet those
8 standards and run them on a regular basis. So we
9 are in favor of mandating that certain stress
10 testing be done to meet certain standards. We
11 understand the concern of wanting to quantify
12 things, but our concerns is how do you standardize
13 those things because the stress test for
14 commodities are going to be different than for
15 credit than for equities than for interest rates.
16 So we're just very concerned about that potential,
17 sort of, problem.

18 So for us, that is less of an issue
19 other than that they're being mandated stress
20 test. They meet certain standards that can be run
21 and conducted on a regular basis, and that the
22 appropriate people at CCPs attest that they are

1 done, and, you know, put their name down that
2 they're run. That they signed off on them on a
3 regular basis. So that's first and foremost.

4 In terms of liquidity, a bunch of people
5 made this point, but I just want to stress, and I
6 know that this is a sensitive topic for you and
7 many people here and it's not your fault, but I do
8 think that it is important that the stress
9 testing, liquidity stress testing take into
10 account that the collinear relationship between
11 times of stress and the people who provide
12 liquidity during times of stress go away.

13 So that is to say the people who
14 provided lines of liquidity may be the same people
15 who are defaulting or not have access to provide
16 lines of liquidity. So that is something to think
17 about given the current construct. I know you're
18 working on fixing the current construct, but given
19 the current construct you may not. So I would
20 say, if you can't fix the construct you should
21 think about it.

22 The last thing I would bring up, and I

1 know we're going to get into this later is sort of
2 the defaulter pay model and liquidity management
3 in terms of things is you need to have a
4 well-defined structure for how things are paid in
5 the event that a stress occurs and people start
6 losing money. Who pays what, when, and how? And
7 it is key that part of the model is defining where
8 everyone falls, where they get that liquidity, and
9 the best way to ensure that is to make it clear
10 that two things are occurring. That each CCP is a
11 fiduciary.

12 Part of the remit of a CCP is to clearly
13 state they are a fiduciary. We just talked about
14 \$300 billion and how we can sit around here and
15 say that \$300 billion at what is concentrated in
16 probably three CCPs, because that's where the vast
17 majority of the capital is, maybe it's four or
18 five, but vast majority is three to four, of that
19 \$300 billion is sitting in very small silos.

20 Telling these people put their hands up,
21 we're fiduciaries and they have to run their
22 stress tests like that and they have to have skin

1 in the game. That is key to how they define
2 things, and the waterfalls need to define that for
3 losses.

4 MR. WASSERMAN: Jacob?

5 MR. FEDJE: Thanks, Bob. I just wanted
6 to quick bring up the topic of disclosure again.
7 I understand the clearing members' viewpoint of
8 wanting disclosure for stress testing, but I do
9 also want to echo Sunil's concern about
10 confidentiality, especially with MGEX or really,
11 really small DCO. That confidentiality concern is
12 even more so important considering the very small
13 basket of products, essentially one, in our case.
14 That provides an easy way for people to kind of
15 back into various positions and, I guess, each
16 clearing member's, you know, stake in that, so.

17 MR. WASSERMAN: Dale?

18 MR. WASSERMAN: I would like to, from a
19 CCP perspective, echo what Marnie, Nico, and Bill
20 were saying about liquidity facilities with the
21 need for greater liquidity from the IOSCO
22 principles and the guidance. We are, basically,

1 embedding wrong way risks because the same folks
2 that were going to be providing liquidity, because
3 the numbers have those bank lines of the same
4 folks are going to be stressed.

5 The OCC is taking a lead as far as
6 trying to get non-bank facilities going through a
7 line of captors, but that's still not good enough.
8 We need to have other ways. I know I'm probably
9 talking to the wrong audience, but just on the off
10 chance that someone from the Fed might be surfing
11 the net and hit this on YouTube I'm going to say
12 that CCPs need to have access to the Fed for
13 liquidity rather than having the intermediary of
14 the clearing member firms.

15 MR. WASSERMAN: I will note, Dale, it
16 is, I think, the intention of the guidance that
17 you do need to take into account, basically not
18 only liquidity needs, but stresses that might
19 affect liquidity sources. To the extent that
20 that's not clear we should definitely be told to
21 make it clearer.

22 Eileen and then Bill Thum, and then as I

1 said, we're going to have to end at that point for
2 this session.

3 MS. KIELY: Thank you so much. My name
4 is Eileen Kiley and I'm here representing
5 BlackRock. Ultimately, I'm representing the
6 thousands of end users of derivatives, the
7 investors that BlackRock invests on behalf of.

8 Because this is a public forum I'm going
9 to make some statements that may be very obvious
10 to those immediately around this table, but I
11 think it's very important for us, as fiduciaries,
12 that our customers hear this kind of information
13 and really understand what we're talking about
14 here.

15 So, to start, stress testing is
16 generally used by CCPs to inform the overall size
17 of the financial safeguard package. That is why
18 this process is so critical to the safety and
19 soundness of CCPs. Something that is that
20 critical requires a great level of scrutiny and we
21 welcome the additional guidance that the
22 CPMI/IOSCO has provided with this updated

1 guidance.

2 Specifically, the making sure that
3 stress tests actually mirror day-to-day operations
4 practices, and, as Bob called it, they will be
5 bound by reality. I think that is a very
6 important element that this adds. Second, and
7 something I don't think has been mentioned yet
8 today, disallowing the inclusion of excess funds
9 that have been posted by clearing members and the
10 clients should not be, you know, should not be
11 included in stress tests. Those funds are put,
12 generally, as operational buffers to allow for
13 operation groups to alleviate their workload. But
14 if any sign of stress were to come out that money
15 is going to be pulled back.

16 Third, specifically requiring the
17 inclusion of other key participants in the credit
18 liquidity stress testing which everybody's been
19 talking about so far. This idea that, you know,
20 you're a clearing member could also be your
21 liquidity provider. Absolutely, we support that
22 that happens.

1 Specific to the question that was asked
2 to the panel about the historical -- including all
3 historical stress tests or historical prices
4 movements in the stress tests. I struggle to see
5 how anyone could, with certainty, say that
6 historical price volatility could not reoccur.

7 So, therefore, while we recognize this
8 might introduce some volatility and some outliers
9 to CCPs statistical analyses I don't think they
10 should be avoided or ignored. Adjusting scenarios
11 for relative versus absolute may be appropriate,
12 as suggested by the guidelines, but taking them
13 out altogether we fell would be inappropriate.

14 I just want to echo what very many
15 people have said, disclosure of the scenarios run
16 is very important to us, and, in particular, the
17 scenarios that inform the size of the default fund
18 is very important. We recognize the guidance
19 does, indeed, prescribe that. Thank you.

20 MR. WASSERMAN: We'll talk more about
21 disclosure on our third panel. Bill, you get the
22 last word.

1 MR. THUM: So I just wanted to build on
2 a comment that Marnie made with respect to initial
3 margin, its use as liquidity. I was going through
4 the report earlier today and flagging different
5 paragraphs. If it was my daughter's Instagram
6 account I would probably put likes next to
7 Paragraph 5.1.2 which says, initial margins use is
8 to cover potential future exposure to a
9 participant and not serve as a liquidity pool or
10 pool to address other defaults. So that's a great
11 paragraph in the report.

12 I think if it is to be used as a source
13 of liquidity then I agree with Marnie. Its use
14 must be subject to mandated specific guidelines
15 and regulatory oversight, including the provision
16 of collateral limits on the amount and duration of
17 use, and receive senior debt claim status to be
18 paid back ahead of shareholders. That's all I
19 have to say.

20 MR. WASSERMAN: Thank you. In which
21 event, we come to the end of our first panel. We
22 will have a 15 minute break. If I could ask

1 everyone to please be in your seats and ready to
2 resume at 10:35, precisely. Thanks much.

3 (Recess)

4 MR. WASSERMAN: Thank you very much, and
5 thanks to everyone for being very, very prompt.
6 Our second panel is on margin, and specifically
7 the focus is on margin methodologies and
8 essentially how CCPs determine how much margin to
9 charge.

10 I'd like to start with a question that
11 is covered in both the guidance and the cover
12 note, which is with respect to the margin period
13 of risk, an issue that had been of some small
14 discussion internationally among a couple of
15 jurisdictions.

16 The PFMIs do not prescribe a minimum
17 margin period of risk. Is further guidance in
18 this area needed? Who would like to start?

19 MR. FERNANDEZ: We think that some
20 guidance on minimum MPOR would be useful. Of
21 course, that should be linked to the types of
22 products, the specific products and asset classes

1 that a CCP is clearing.

2 I think in general the guidance is very
3 good about outlining that for all of the different
4 requirements in the margin space, but I think in
5 particular for MPOR, some guidance would be
6 helpful, reference the product, the depth of the
7 market, and the impact of individual participants
8 to follow up on a given market. I think those
9 should be considerations.

10 MR. WASSERMAN: Thank you. Sunil?

11 MR. CUTINHO: I also wonder, on some of
12 the points that -- I forget your name. Andres. I
13 haven't met Andres before. Some of the points
14 Andres made. I think the thing to keep in mind is
15 especially the second part of what Andres was
16 suggesting, MPOR is a function, it is a function
17 of the risk profile of the product.

18 We got into a lot of discussions, you
19 pointed to that. There are a lot of factors
20 involved in actually picking margin period of
21 risk. One of them, and there are a few of them,
22 but one of them is liquidity in the product. The

1 other is concentration of that liquidity in the
2 product.

3 Having a prescriptive MPOR is something
4 that we feel will be too restrictive and can
5 actually undershoot in some circumstances and
6 overshoot in some circumstances.

7 I feel there should be a process between
8 regulators and us, which exists in the U.S., where
9 you visit us very often, and where we spend some
10 time discussing these topics, but having a blanket
11 single standard that applies to every product, I
12 think that is not very effective.

13 MR. WASSERMAN: Okay.

14 MR. DABBS: Yes, I think we have spent a
15 lot of time talking about the risk of the product
16 and liquidity of the product, but I also think
17 it's important to recognize the timing of the
18 margin requirements and their payments. For
19 clearing members and for house positions, those
20 are basically on demand requirements, so we need
21 margin calls intraday and we also need them at the
22 CCP's discretion.

1 However, for client positions, those are
2 generally collected on a T+1 basis, so margins due
3 the following day from a variation perspective.

4 I think we also need to recognize when
5 the clock starts because if you have a default of
6 a clearing member, which is the main scenario we
7 are thinking of, you have default of a clearing
8 member, and you have effectively gone two days
9 without the client meeting margins, because the
10 first day, they didn't have to meet margin, there
11 was no requirement for them to meet variation, and
12 the second, because they wouldn't have met it
13 until the coming day, and the second day, they
14 won't pay to a defaulted clearing member.

15 So, now the CCP is facing the credit
16 risk of those clients without a guarantor, and
17 it's been two days since variation has been
18 effectively collected in that circumstance.

19 We do think the timing of one day for
20 positions where you have intraday requirements,
21 you could make that justification, but I think
22 it's important to recognize the timing of when

1 variation is actually due.

2 MR. WASSERMAN: Okay. I have Chris,
3 Dale, Scott, Marnie, and then I'm going to want to
4 move on to the next question, if I may. Chris?

5 MR. PERKINS: Thank you. The issue with
6 MPOR is we don't like when labels are attached to
7 MPOR, like futures is two days, and swaps, five
8 days, as an example. It should really be based on
9 the underlying liquidity of the product, based on
10 qualitative and quantitative factors.

11 The other issue with an MPOR is that if
12 there is a regulatory minimum for MPOR, the market
13 will manage to that level. We think there should
14 be a number of qualitative and quantitative inputs
15 that are put into when a CCP establishes an MPOR.

16 We talked about some of the
17 quantitative, but when you look at qualitative,
18 look at the number of CCPs in the space, number of
19 clearing members in the space, the concentration
20 amongst clearing members. That's it.

21 MR. MICHAELS: I echo what Chris had
22 mentioned. It is about the product, coming up

1 with one MPOR fits all. We have seen the
2 regulations evolve where you do see different
3 MPORs for OTC products versus exchange traded.

4 I think my worry is MPRO is one piece of
5 the margin. Then you start talking about
6 seasonality of the products. That is another
7 piece. Concentration. Add-ons. Liquidity.

8 If you start going into each individual
9 level, start being very prescriptive, you add in
10 procyclicality, being prescriptive on that, you
11 end up getting into almost a Frankenstein margin
12 model where you have all these pieces being very
13 prescriptive but are you looking at things
14 holistically, are you looking at things across the
15 board, making sure the CCPs are doing the right
16 thing from the overall product and the liquidity
17 and the breadth that is in the markets.

18 MR. WASSERMAN: Scott?

19 MR. HILL: I agree with what Dale and
20 Chris have just said. I think you do have to take
21 into consideration all aspects of the model. We
22 have talked about concentration, what your

1 intraday policy is, unit gross or a net regime.

2 I think there are any number of factors
3 that should be determined, and it should go by the
4 market. It's not the case that two days works for
5 every futures market. It's not the case that five
6 days is appropriate for every OTC market.

7 I think less prescription in this area
8 is better.

9 MR. WASSERMAN: Marnie?

10 MS. ROSENBERG: Thanks, Bob. Marnie
11 Rosenberg, JP Morgan. From a risk perspective, we
12 do believe that the MPRO again is one parameter,
13 one assumption, that goes into a margin model.

14 However, to what John already said, from
15 a client perspective, when you look at actually
16 the rules that we have looked at in terms of time
17 that the clearinghouse gives for client support,
18 it is way too short. I think that making that
19 assumption is not in conjunction with the
20 objectives that the market has for non-defaulting
21 clients to an alternative clearer.

22 I would also say that we look at,

1 obviously, all of our listed derivative
2 memberships globally, and when we look at the
3 margin model and the MPRO and the liquidity of the
4 contracts, we don't believe that an MPRO of one is
5 sufficient.

6 I would also say when we look at the
7 concentration or liquidity add-on methodology for
8 listed derivatives, again, talking about globally,
9 we don't think the methodology is transparent and
10 necessarily addresses the ill-liquidity of the
11 underlying contract. It really addresses
12 concentration with some of the largest members,
13 and how much risk those members bring.

14 I think the MPRO needs to be addressed
15 in conjunction with any kind of add-ons, like
16 concentration and liquidity, and given that right
17 now I don't think we have a consistent or strong
18 universal regime for that, I have a hard time
19 suggesting even for house positions that one day
20 would be sufficient.

21 MR. WASSERMAN: Stephen?

22 MR. BERGER: I just want to quickly echo

1 others. We agree there should not be a rigid
2 minimum prescribed, and I guess I would note there
3 are already arbitrary minimums for cleared swaps,
4 for example, of five days, which may or may not be
5 appropriate today or continue to be appropriate as
6 those markets evolve. I would caution against
7 having rigid minimums.

8 MR. WASSERMAN: Nico, I think you will
9 have the last word on MPRO.

10 MR. FRIEDMAN: Probably in agreement
11 with what has been said, and I think the comment I
12 would have about the guidance, particularly around
13 some of the more complex elements of margin
14 methodologies, which is kind of the aspects we all
15 worry about, which is not observable, so the
16 liquidity, the concentrations, the seasonality.
17 These are really difficult topics to address.

18 The concentrations, mentioned as
19 elements of the margining system, and on the one
20 hand, yes, you could end up with extremely complex
21 margining models that take into account all of
22 that, but I personally think it is necessary.

1 Often times in the context of our
2 discussions with CCPs, we get very generic answers
3 around yes, we take into account liquidity or
4 concentration, yes, we do take into account.

5 The reality is these are such important
6 risk factors, in the context of CCPs having a lot
7 of visibility around trading volumes that can be
8 incorporated into the margin methodologies or
9 interest for products that could be incorporated
10 into concentration, add-ons, I believe it should
11 be more formulaic and that would help certainly
12 with confidence that those purchases are robust.

13 MR. WASSERMAN: One issue which folks
14 have been speaking about a lot, certainly in the
15 context of margin but elsewhere, is the issue of
16 procyclicality. There is some discussion of that
17 in the guidance, and certainly this is something
18 we have been very concerned about from a U.S.
19 perspective.

20 I guess the question I'd like to put out
21 on the floor is whether measures to limit the
22 effects of procyclicality in the context of

1 margins should be mandated, and if so, should
2 those measures be principle based or prescriptive?
3 I'd like to recognize my colleague, John Lawton,
4 as the first person to address this.

5 MR. LAWTON: Thanks, Bob. Some of us on
6 the staff would probably say we think it should be
7 more principle based. We have looked at some of
8 the prescriptive measures in this area, and they
9 seem to be solutions in search of a problem.

10 Basically, staff has looked at data from
11 a period of over six years and four large
12 contracts in different asset classes, and the
13 demands on liquidity from increases in initial
14 margin were pretty insignificant in size and
15 frequency when compared to demands for variation
16 margin.

17 The largest VM demands in the four asset
18 classes ranged from 5 to 16 times as much as the
19 largest IM increases.

20 In one contract, there were actually 924
21 days when market moves generated VM payments that
22 were greater than the single largest IM increase.

1 In addition to being smaller, liquidity
2 demands generated by IM increases also were less
3 frequent.

4 In the asset classes reviewed, IM
5 increases occurred on no more and generally less
6 than 7 percent of the trading days. Another point
7 we noticed is when there were increases, they
8 tended not to be clustered.

9 By contrast, we saw numerous instances
10 when there were four and five days in a row where
11 VM demands were many times larger than any
12 increases in IM.

13 In sum, we are sort of puzzled as to why
14 such emphasis has been placed on some of these
15 prescriptive measures in the calculation of IM.
16 It would seem a risk based model that incorporated
17 periods of extreme volatility into its inputs and
18 that achieved 99 percent coverage would largely
19 address cyclical concerns.

20 In addition, we do have some concern
21 that if there is any implication that a DCO would
22 feel constrained from increasing IM because of

1 cyclicality issues when they thought because of
2 prudence they really should increase IM as a
3 matter of systemic risk.

4 MR. WASSERMAN: I have Bill D. I have
5 Sunil, Chris, Scott, Dale, and Nico. Bill?

6 MR. DeLEON: Bill DeLeon, PIMCO. We
7 agree that any prudent risk management system
8 should have a factor of four procyclicality. We
9 believe it should be principle based, not
10 prescriptive. We agree, and I think the data that
11 John just mentioned sort of proves that the vast
12 majority of models are already calibrated by most
13 CCPs to incorporate these procyclical effects,
14 that is why you don't see these types of effects.

15 We know that in our risk management
16 models, we have incorporated floors and moving
17 averages to prevent situations where when you
18 enter periods of incredibly low volatility, you
19 don't rely upon the most recent periods of low
20 volatility to calibrate because you will have
21 periods of historic, where things do spike again,
22 and you don't want to have incredibly low initial

1 margin regimes and then wind up blowing up a CCP
2 or not have enough margin in.

3 We agree there should be principle based
4 models for this. We also believe that most models
5 out there are calibrated already, and good risk
6 management systems will allow for that or be
7 designed that way.

8 MR. WASSERMAN: Thanks. Sunil?

9 MR. CUTINHO: I want to echo some of the
10 points, but I just want to give some examples as
11 well. This goes to the point that Dale was
12 making, Frankenstein, if I could borrow that term.
13 Let me try a few ideas. I'm going to respond to
14 Dale as well as Nico and a few things that Bill
15 said.

16 The first thing is that from our
17 experience, what we have learned is in some
18 jurisdictions they have very prescriptive tools on
19 how to calibrate procyclicality. They have chosen
20 to specify the tools versus go to the principle
21 that margin models should be anti-procyclical.

22 The problems that we see are that

1 actually they achieve the reverse. They end up
2 being procyclical. The tools prescribed ended up
3 being procyclical. That is one. Second is we
4 found them to actually be under margin risk. That
5 was another issue that we saw.

6 Third is they did not fully appreciate
7 the fact that in risk management, there has been a
8 lot of innovation, and at this table, there are a
9 lot of ideas being exchanged, especially when
10 margin models are being designed, and there has
11 been a lot of innovation. There are so many other
12 tools to take into account when you think of
13 anti-procyclicality. Bill had mentioned a few.

14 There are things like implied volatility
15 where the market itself signals what the
16 volatility is going to be in the future. Dale
17 pointed to seasonality. In some sense, I
18 appreciate where Nico is coming from, that there
19 is a diversity of margin models out there, and
20 they need to have different risk factors, and they
21 need to address all those different risk factors.

22 Having a regulator prescribe that is

1 what we have significant concerns with, in the
2 sense that you would end up undershooting
3 significantly and not allowing other mechanisms to
4 manage procyclicality. We have seen that. We
5 have had firsthand experience with that during the
6 equivalence process.

7 The second part, I wanted to just
8 appreciate where John was coming from. I
9 mentioned some of this during the stress testing
10 panel. If you look at it, CCPs should be very
11 aware of their impact on the broader ecosystem.

12 Issues that we found on the day after
13 the referendum were actually driven by practices
14 that some felt were normal course of business but
15 continued to do so and extract a lot of let's say
16 losses. They were just covering the losses.
17 Assuming these are uncovered losses.

18 We were surprised that some people
19 considered these market movements uncovered
20 because there is margin collateral sitting there,
21 there are a lot of assets sitting there to cover
22 the risk, and as Dale pointed out in previous

1 panels, one of the things that CCPs do is on a
2 real time basis, monitor how these positions
3 change, and we are also comparing that against the
4 collateral that we have at our disposal.

5 If we simply have triggers that sit
6 there and collect money, as John pointed out, VM
7 numbers are significantly high, especially during
8 stress. That is very procyclical.

9 It seems like we seem to be so narrowly
10 focused on our margin methodology when if you look
11 at the totality of a CCP's actions, procyclicality
12 shows up in many areas, and a CCP should be aware
13 of their actions.

14 The third one is gross versus net. I
15 know we stated that, I don't want to beat this
16 horse, but what is very funny to us is the numbers
17 that we are pointing out in terms of margin
18 changes, they are so small compared to what
19 happens when you have a net margining regime, and
20 there is a member failure.

21 In a net margining regime, the CCP has
22 less collateral across the client book of a

1 clearing firm, and if that clearing firm had a
2 default, you have a procyclical trigger there
3 right away forcing clients to put up more margin
4 to get their positions supported, and that is
5 significantly procyclical rather than these
6 statistical measures that we are looking at.

7 So, in a sense, I think I appreciate
8 where John is coming from, there is a lot more
9 focus on a very, very narrow aspect of margining,
10 with respect to procyclicality, and we are
11 forgetting the bigger picture.

12 MR. WASSERMAN: Chris?

13 MR. PERKINS: I agree a lot with what
14 Sunil said, and I wanted to start by referencing
15 the crash of 1987. In the aftermath of that
16 crash, the Brady Commission report came out and
17 cited some of the dangers of intraday one-sided
18 margin calls and their contribution to
19 procyclicality.

20 Unfortunately, today, we live in an
21 ecosystem that is very tied together. We have
22 mandatory OTC clearing. We're seeing CCPs behave

1 differently, resulting in what could be a
2 liquidity race to the bottom, highlighting some of
3 the procyclical nature of intraday margin calls.

4 We believe that CCPS again should look
5 at the stresses in the system. They should
6 mitigate those stresses through the traditional
7 waterfall, initial margins, skin in the game, and
8 guarantee fund and assessments.

9 When CCPs start calling intraday, it
10 provides stress in the system because the other
11 CCPs think they have to as well. If they have
12 robust collateralization and waterfalls already,
13 they shouldn't have to move every time there is a
14 market move. It's incredibly important.

15 The other issue that we are facing is we
16 are seeing intraday margin calls that cannot be
17 one-sided. If a CCP has to call intraday, we
18 think that call should be coordinated with other
19 CCPs. It should be coordinated with the
20 regulators. It should flow in both directions, so
21 payors should be paid, people that owe money
22 should pay.

1 The practice of one-sided calling
2 further exacerbates procyclicality. We think
3 there should be additional prescription around
4 avoiding that practice because it is very
5 dangerous, and it could be in the next stress.
6 Thank you.

7 MR. WASSERMAN: Okay. I have Scott,
8 Dale, Nico, Isaac, Bill T., and Marnie. Scott?

9 MR. HILL: I completely agree that we
10 shouldn't just focus on the impacts of
11 procyclicality and IM. You have to look at
12 variation margin. You have to look at the various
13 add-ons, concentration, et cetera, all of which
14 can be extremely procyclical. Any margin model
15 has to consider all of those factors and the
16 procyclicality impacts.

17 I do think there is a reasonable view
18 that says within your IM, you ought to consider
19 procyclicality. I think even as John noted, there
20 is some small amount of procyclical impact.

21 We have actually had to deploy one of
22 the three Amir methods in our London

1 clearinghouse. I will tell you I am very much in
2 favor of being principle based having gone through
3 that.

4 If you look at the three prescriptions,
5 in our view, two of them just don't work, one is
6 add 25 percent, which unless you have a way to eat
7 into that is just add 25 percent. Over time, it
8 is completely procyclical. Another is to look at
9 the average over 10 years, which works until you
10 are above that average.

11 I do think any margin model and every
12 element ought to be able to demonstrate how it
13 deals with procyclical and how it mitigates
14 procyclical impacts, but I think that ought to be
15 a principle, and I think any attempt to prescribe
16 APC on IM, on VM, on add-ons, I think it's a fools
17 err. I don't think you can do it.

18 MR. MICHAELS: First of all, to John, I
19 appreciate you and your staff's work on looking at
20 some of the details on procyclicality. I think
21 you have come up with some great insights into the
22 issues here, or non-issues, if you will.

1 One of the things I want to say on the
2 procyclicality point, I think you are seeing that
3 CCPs have generally already achieved that, if you
4 look at the outcomes, as John pointed out. A lot
5 of the procyclicality measures that folks want to
6 see are already embedded into the CCP's practices,
7 without getting so prescriptive as some of the
8 other regulations out in Europe.

9 One thing I want to add and perhaps to
10 Nico's point, one thing we are very much an
11 advocate of is transparency. What are the
12 liquidation charges, or what are the
13 procyclicality measures?

14 It should be transparent to the markets
15 so it can be replicable, so that folks know if
16 there are market moves, they know what the margins
17 are going to be moving to, so it's not only just
18 making sure that we are taking it in, but the
19 market understands the measures that we are doing,
20 whether it be procyclicality or liquidity or
21 seasonality, people can understand it and
22 replicate for their purposes, either at a member

1 firm or on the buy side.

2 MR. WASSERMAN: Nico?

3 MR. FRIEDMAN: Just a couple of points.
4 Procyclicality is an important topic, perhaps my
5 view is to be slightly more prescriptive. In
6 terms of the prescriptive approaches, that could
7 include loop back pairs, pairs of stress or some
8 buffer, those could have some merit.

9 For example, a couple of years ago in
10 the winter of 2014, there was a lot of volatility
11 in the energy markets. When I think about
12 coverage, I think about the number of bridges,
13 which is one thing, also the magnitude of the
14 bridges. It is one thing to bridge by a little a
15 few times in a row.

16 I think the reactions from CCPs in that
17 context was reasonable. CCPs involving energy
18 markets ramped up their initial margin, they
19 didn't do it all at once, they were careful to
20 progressively ramp up the margin levels, and in
21 that context, I think a buffer could help.

22 In terms of perspectives, I personally

1 have a lot of respect to the risk management
2 expertise of those CCPs, and the best way to
3 probably prevent procyclicality is to anticipate
4 potential events and dislocations in the markets,
5 the macro risks out there, the outcome of those
6 events.

7 Brexit is one of them, it could be put
8 into just to anticipate and increase initial
9 margin way before you get close to those events,
10 so that you build in the additional protection
11 over some period of time as opposed to having to
12 react through unpredictable intraday margin calls
13 the day of the events.

14 MR. WASSERMAN: Let me press you just
15 for a second. I do have a great deal of sympathy
16 about the concept of if you have an anticipated
17 event, maybe you should be preparing for that, but
18 in an ecosystem where clearing members are of
19 necessity set up, I think they have fantastic
20 treasury functions that are set up to meet
21 whatever might happen in variation margin.

22 How much is the significance of

1 increases in initial margins, sort of what John
2 was talking about at the beginning?

3 MR. FRIEDMAN: So, large clearing
4 members only take into account in their liquidity
5 management some amount of intraday variation
6 margin calls. The endpoint of initial margin is
7 also with respect to the clients, their own
8 liquidity, and helping clearing members manage the
9 risk against those clients.

10 If you get to levels of volatility that
11 were not foreseen, that could result in liquidity
12 calls on clients, and that is something that CCPs
13 could help us with. In other words, we enter
14 volatility, the initial margin that is CCP driven
15 is insufficient, it would be better to prepare the
16 markets more broadly and build buffers.

17 MR. WASSERMAN: Okay. Isaac?

18 MR. CHANG: Thank you. Maybe once I
19 would just like to preface what I say, one of the
20 contexts in which we think about these issues is
21 both from a risk management perspective but also
22 from the perspective of an asset management firm

1 that has to execute and trade in these markets
2 every day.

3 The one thing I would mention that I
4 would remiss in not mentioning is that I think we
5 can probably think about a lot of these topics
6 somewhat like purchasing insurance.

7 There is a tradeoff here, I think, where
8 we need to thread the needle between -- if
9 insurance premiums were too high, people just
10 won't buy it, right, and the government is dealing
11 with this in other aspects right now, and there is
12 a direct impact on market liquidity, which is
13 another concern that lots of people have raised.

14 As an asset manager who does traffic in
15 many essentially cleared products and broadly
16 supports central clearing, in topics like
17 margining, I think that is one of the perspectives
18 that at least we don't want to lose.

19 You can build a system that is
20 absolutely safe and can never fail, but no one
21 ever trades, and then I think we have missed the
22 boat in terms of how do you design. What are we

1 trying to get to at the end of the day?

2 That's not to suggest that any of the
3 panelists have suggested anything that I think is
4 getting there, but I do think at least that's one
5 of the tradeoffs that I think is implicit in all
6 of the conversations and perspectives that we are
7 bringing.

8 I'd say on this topic specifically,
9 generally we believe both that adjusting margin
10 for volatility is just sound risk management
11 practice.

12 Now, I'd agree also with what Bill said.
13 To do it completely formulaically without
14 considering sort of more -- to do it in a naïve
15 way is not the right way to approach it. You
16 want to consider historical context and think
17 about things like floors and downside and so
18 forth.

19 But broadly speaking, we feel like this
20 is a responsible way to think about the
21 marketplace, even though we understand the
22 potential stresses, and the answer is what else

1 would you do if you don't increase margins when
2 volatility goes up, that seems to us to be not a
3 particularly responsible perspective.

4 We also strongly agree with a lot of
5 what was said about the approach really best being
6 principles based. Frankly, if the approach is too
7 perspective, I would argue we would introduce more
8 systemic risk because two clearinghouses trading
9 the same products and make margin calls at exactly
10 the same time for the exact same amounts, exactly
11 same positions, some amount of diversification in
12 the system, in risk management, as long as it
13 meets sort of baseline sound practices is actually
14 better, I'd say, for the overall health of the
15 system.

16 The last thing I would say is both on
17 this topic and the topic we talked about earlier,
18 stress testing, as a buy side participant that has
19 had to make the transition from a bilateral to
20 essentially cleared world in lots and lots of
21 products, transparency for us we feel is an
22 absolute necessity for us to frankly be able to

1 responsibly manage the risks of our portfolios as
2 a fiduciary for our clients.

3 We need to understand how much cash we
4 need to have on hand. We need to understand the
5 levels of free cash we need to hold in different
6 products.

7 You know, while I know there has been
8 some discussion on the nature of one-sided margin
9 calls, I think, by some of the other participants,
10 I would just say again from our perspective as a
11 diversified asset manager, that's extremely
12 problematic because we often have one position
13 that is offset by another, and to the extent they
14 are either at different clearinghouses, so cash
15 from one is intended to offset the other, or an
16 un-cleared product where there is bilateral
17 collateral that is being posted.

18 Regardless, I think, of the eventual
19 answer, we feel like transparency, allowing an
20 asset manager like ourselves to have a good
21 understanding of when cash will be required allows
22 us to act in a responsible manner to make sure we

1 are prepared and think through all the possible
2 eventualities.

3 MR. WASSERMAN: Okay. I have Marnie,
4 Bill, Eileen, Scott, and Sunil. I will mention
5 one thing, which is if folks could to a certain
6 extent focus a bit on what the guidance currently
7 says.

8 Are there things that are good, are
9 there things we should change? In other words,
10 ultimately, we need to come to a place which I
11 hope will be the right one, so to the extent you
12 can help us come to that right place, I would view
13 that as very helpful. Marnie?

14 MS. ROSENBERG: There are a couple of
15 points I would make on procyclicality. First is
16 sort of supporting what Chris said, which is the
17 intraday margin calls on VM and IM in a crisis
18 creates a lot of liquidity strains. As a member
19 but as a risk person, I would say from both a
20 house and client perspective, the challenge is
21 predictability and transparency to what Isaac
22 said.

1 I get questions related to our own
2 liquidity stress testing. Marnie, what
3 assumptions should we make about what a multiplier
4 under stress conditions the clearinghouses could
5 apply in our IM.

6 It is something that we need to
7 understand and we worry about. We want to ensure
8 we are being prudent meeting our own regulatory
9 requirements.

10 I think on the VM point, John, that you
11 made, the end of day, the end process, is a
12 process that exists and that we plan for. On the
13 intraday piece, when we get called for VM, we do
14 believe there should be pass-throughs within a
15 given clearinghouse. It shouldn't be one-sided.
16 That is creating problems in the market.

17 From an IM and procyclicality
18 perspective, I would say there are different ways
19 to address it. We do happen to like the Amir 25
20 percent buffer, but with the ability to use that
21 buffer in a crisis. Amir actually allows you to
22 do that. We only know of one clearinghouse in

1 Europe that does that. Twenty-five percent you
2 could say is arbitrary, but I think as a concept
3 having a buffer, whether it be for intraday margin
4 calls and market movements or if it be sort of
5 from an IM perspective, we think is a good
6 practice.

7 I think we should focus on what the
8 objective is, which is ensuring that participants
9 can meet their margin calls in a timely manner. I
10 think the delays in order to get internal
11 approvals for large movements could be
12 problematic, so we want to protect the system.

13 I think ensuring whether it be floors in
14 the model, whether it be a 10 year look back
15 period, which we think should be a universal
16 standard, whether it should be a buffer, I think
17 there are different ways to address the issue.
18 Thanks.

19 MR. WASSERMAN: Bill T.?

20 MR. THUM: Yes. I wanted to build on
21 some of the points that have already been made.
22 When we talk about MPOR or indeed the margin

1 add-ons, we really can't talk about them in
2 isolation. We have to talk about them in the
3 context as well as the first panel, stress testing
4 and disclosure, and the panel to come, CCP
5 contributions to the default fund.

6 As we moved into the cleared space, I
7 think many buy side participants were somewhat
8 frustrated by what was perceived to be an
9 arbitrary MPOR for cleared swaps of five days,
10 also the 10 days for un-cleared swaps. Certainly
11 realized it was kind of a compromise, almost quick
12 and dirty approach that was applied to the rule to
13 get us through the door.

14 Our sense though is that it overstates
15 the risk for some products, understates the risk
16 for other products. It forces us to put margin
17 into a system that may be excessive in many cases.
18 What to do, if there is no minimum floor on MPOR,
19 how does the system have credibility,
20 understanding, of course, the clearinghouses are
21 looking at it with laser focus and rebalancing and
22 assessing.

1 This is where stress testing and
2 disclosure comes in, can we have ex-ante tests
3 where we look at what the clearinghouses have set
4 for both the MPOR and for margin add-ons and see
5 to what extent they are tracking appropriate for
6 the risk as presented over time.

7 I think having it done in a principled
8 way together with ex-ante stress tests and
9 disclosure is a possible means to reinforce not
10 only the appropriateness of the amount but the
11 credibility of the approach and the discipline
12 within the system so that the Commission can
13 expect and anticipate the good work that is being
14 done on a daily basis will be done, and there is a
15 review as to the performance of doing those
16 calculations, and the market has some
17 transparency.

18 MR. WASSERMAN: Let me press just for a
19 moment because one of the points I think you made,
20 and Isaac, I think you made this as well, is that
21 clients need to understand what calls are going to
22 be made on them. I note the guidance currently

1 says, and I'm looking at 2213, that the Board
2 should ensure that the CCP conducts regular and
3 vigorous due diligence of its participants'
4 understanding and the ability to predict and
5 manage potential changes in margin.

6 What I think I am hearing you all say is
7 that perhaps that needs to go further and
8 essentially you are looking both at the level of
9 the participants but also at the indirect
10 participants, the clients, and as well there needs
11 to be sufficient information going out so that
12 essentially folks can have the tools to manage
13 those calls.

14 Is that where folks are going?

15 MR. THUM: I think it is both managing
16 expectations going forward and also having
17 confidence that not only are our positions being
18 appropriately margined but our brothers and
19 sisters' positions that are coming to the table
20 are being appropriately margined as well.

21 When you set a floor -- well, when you
22 set no floor, the risk is there is competitive

1 reasons why a margin may be set. When you set a
2 floor, that could be the target that is aimed at
3 without actually recognizing there is additional
4 risk that is being brought into the system.

5 Yes, I think it is an ability to be able
6 to anticipate what our obligations will be but
7 also to have credibility in how those obligations
8 are being calculated and confidence in them.

9 MR. WASSERMAN: I have Eileen, Scott,
10 Sunil, John D., Dale, and Bill D. Eileen?

11 MS. KIELY: Thank you. I'll be brief
12 here. A couple of comments. First, quickly, I do
13 think volatility floors are very appropriate when
14 we are talking about procyclicality. A lot of the
15 CCPs have diligence. That seems to be a fairly
16 common practice but not universal. Secondly, I'll
17 reiterate what we are hearing, and Bob, exactly
18 what you said, which is as an end user, we need
19 the tools to be able to predict what those margin
20 calls could be, and we need the transparency to be
21 able to do that.

22 We have access to some margin models

1 through our clearing members to be able to do such
2 a thing, but it is very sporadic. I would even
3 suggest is there some type of a sensitivity
4 analysis that could be standard disclosure that is
5 given to clearing members and customers to give us
6 a sense of what market moves might lead to margin
7 calls.

8 MR. WASSERMAN: Thanks. Scott?

9 MR. HILL: Just to directly address your
10 point, I think with regards to the guidance, our
11 view is procyclicality is something that should be
12 considered but it ought to be considered as a part
13 of a holistic risk model, not just IM.

14 I go back to Nico's point and the energy
15 movements in 2014, and I agree with him that
16 incorporating in your margin model a buffer that
17 reflects a sizable stress period is a good way to
18 build that buffer.

19 I think it needs to be principle based
20 because if you think about Marnie's comments, she
21 noted they liked the

22 percent method and the rule allows you

1 to determine or eat into that buffer. It's not
2 prescriptive on how or when, and she even noted
3 that 25 percent may or may not be the right
4 starting point.

5 I think our view is procyclicality
6 matters. It matters in every element of the risk
7 model, not just IM, but it does matter in IM. I
8 think there should be international consistency.
9 Having a prescribed set of rules in one
10 jurisdiction and a different prescription in
11 another and having no prescription at all in a
12 third is going to be bad for global markets.

13 Overall, I do think procyclicality as a
14 part of the risk model matters, and there should
15 be efforts to demonstrate how you deal with it,
16 which may include a buffer built on a stress
17 period in the model.

18 MR. WASSERMAN: Sunil?

19 MR. CUTINHO: I will just stick to the
20 points, just to compliment what Scott said. We
21 completely believe in predictability and
22 transparency. I think giving clients and clearing

1 firms, even prospective clients who want to
2 actually bring in risk, having them know what
3 their costs of putting on risk is and how that
4 risk will evolve is something we strongly believe
5 in.

6 We strongly believe in sharing those
7 tools as well. We also have tools where you can
8 stress and see how your margin will evolve,
9 changes in prices as well as changes in positions.

10 The second point I'd like to make has to
11 do with a little bit of what Scott said. None of
12 us here are sitting and arguing against having
13 countercyclical or anti- procyclical buffers. It
14 is just what we are worried about or concerned
15 about is prescriptive tools, and then prescriptive
16 interpretations of those tools. As Isaac pointed
17 out, those can actually introduce systemic risk.
18 That is the basic concern we have.

19 MR. WASSERMAN: Thanks. One other thing
20 I'm going to ask folks if you could address, one
21 of the things -- the guidance does discuss to a
22 certain extent measuring procyclicality.

1 I guess one question I hope folks will
2 over the course of our discussion address is is it
3 practical to measure procyclical properties of a
4 margin system using quantitative metrics? Are
5 there commonly accepted metrics to do this? Has
6 the fitness for purpose of any of those metrics
7 been reliably demonstrated?

8 As we are continuing the discussion, I'd
9 like to hopefully get there as well. John?

10 MR. DABBS: Two points I want to make.
11 I think predictability is what everybody continues
12 to say, and I think predictability from a clearing
13 member and from an end user perspective are
14 equally important in our funding models.

15 To the point about variation versus
16 initial margin, I think there is a very critical
17 difference between the two. From a variation
18 margin perspective, that just reflects market
19 risk, and everybody around this table measures
20 market risk on a daily basis. That is our job, to
21 understand market risk.

22 Measuring that, watching that,

1 monitoring that, is very predictable. Initial
2 margin is not predictable. Initial margin is
3 subjective. We don't have transparency in how the
4 CCP will act.

5 I'm not saying that is a bad thing or a
6 good thing, but that is always going to be a
7 concern. What we have here, if I take the
8 examples of when initial margin is raised, I can
9 look at what the models would say, but they don't
10 necessarily always act in those manners, so they
11 may more slowly raise initial margins, which is
12 again not procyclical but it's not predictable.

13 I think when we obsess about initial
14 margin and variation is because variation, I know
15 the market moved, I know it happened in real time,
16 and I know what I am going to have to fund for.
17 Initial margin is slightly more subjective in that
18 it is a decision-making process and it may be
19 something in the future, and at what point do you
20 start to move in a direction of increasing margins
21 is highly subjective.

22 I know that might happen. I might have

1 it on my calendar. Nobody in this room can say LC
2 is going to act on this date, CME is going to act
3 on this date, ICE is going to act on this date.
4 Everybody is going to be something different and
5 do it in a different way.

6 I'm not saying that is good or bad but
7 that is one of the reasons why we focus more on
8 initial margin and variation just because of the
9 measurement and ease of predictability, for lack
10 of a better term, as it is happening.

11 The second point that we continue to
12 talk about is principles based versus being
13 prescriptive. Again, I would reiterate that I am
14 all for principles based, but we have a
15 fundamental problem in the procyclicality
16 conversation, which is we had an event, it was
17 Brexit, it happened, and one CCP behaved poorly
18 during that.

19 We need to do better, like whatever we
20 do, we need to do better. In my opinion, we have
21 to use that as our example and as our litmus test,
22 because if we don't take that out of the system,

1 then what good are the rules that we are trying to
2 create and the standards we are trying to create
3 if we have an event like Brexit where one CCP
4 behaved very poorly from a markets perspective in
5 managing liquidity.

6 How do we solve that if we don't have
7 something that we look back at, whatever we are
8 writing, and say would it have improved that
9 situation. If it didn't, then we are still living
10 with a huge funding regime that just doesn't work.
11 It did not work, it doesn't work, and we can't
12 continue to repeat that.

13 MR. WASSERMAN: Let me press you on your
14 first point just for a moment, if I may. I take
15 your point that look, you're in the business of
16 predicting market moves whereas there is a
17 different type of variability with respect to IM.
18 On the other hand, I think part of the point is
19 well, yes, but those market moves are much greater
20 in absolute terms than the changes to IM that
21 might follow the market moves, and another point
22 would be, of course, IM could be posted in liquid

1 securities, VM has to be absolute cash.

2 I guess the point I'm thinking is well,
3 yes, but given that you are already set up for the
4 much larger point, how much of a difference does
5 the delta to the IM make to your ability because
6 you are already so well set up for the greater.

7 MR. DABBS: Yes. I think when we think
8 about scenarios and when we think about the stress
9 tests that we run as banks and the buy side runs,
10 from their risk management perspective, I think
11 there are provisions and there are also offsetting
12 positions that cannot be seen in the context of
13 these stats, so we may have other positions
14 performing in different directions.

15 We look at market risk in totality, and
16 we certainly hold capital for that, and we hold
17 funding for that. We can run our models and we
18 can say during those stress periods, how much
19 would we lose, what would happen, et cetera.

20 Now, you are putting those two things
21 together because typically we're going to be
22 losing money, making money, something is going to

1 be happening on our market risk side, plus there
2 is this other scenario where IM is going to be
3 increasing.

4 It's making sure that we understand
5 again the predictability of that IM. We probably
6 know sometimes in our businesses faster than CCPs
7 know how much market risk we are losing,
8 especially in the OTC markets. They may not be as
9 observable to the CCPs as they are to us from a
10 dealer perspective.

11 It's not always unique in that sense,
12 and obviously when we look at net, we look at our
13 net market risk and when those funding sources are
14 due, for lack of a better term. They do go hand
15 in hand, but it is just one that we can predict
16 and predict more in real time and make
17 arrangements for that.

18 MR. WASSERMAN: I am going to go to
19 Sunil, then Dale, Bill D., and Chris.

20 MR. CUTINHO: I'm going to just address
21 your question on tools to measure
22 anti-procyclicality or performance against

1 anti-procyclicality growth.

2 There have been some papers out there
3 most recently incidentally pointing out that a
4 very prescriptive tools based approach is not the
5 most effective way to actually measure
6 anti-procyclicality. Maybe you need to have a
7 more principles based approach.

8 There were a set of tests. The one
9 thing that we noticed as far as those tools are
10 concerned is that they are focused on a static
11 portfolio, and they just measure changes in the
12 margin or the margin of that portfolio that is
13 static over a 30 day period.

14 I think listening to the conversation
15 here the bigger issue or the bigger goal for us is
16 to look at the impact of the changes, taking into
17 account changes in positions, et cetera, at a
18 portfolio level across all the products, on the
19 clearing firms and also the client. That is
20 basically where we think we should focus as far as
21 measuring the impacts.

22 When we look at procyclicality, we look

1 at the impact of our actions on our clearing firms
2 and impact of our actions on clients of those
3 clearing firms to the extent we know them.

4 That is where we think the focus should
5 be. We don't agree that a prescriptive set of
6 tools is a good answer, but in terms of outcomes,
7 let's say, goals, on what those measures should
8 be, I think there is more study necessary to get
9 to the right place. At the outset, it has to be
10 at a portfolio level, and not be so focused on a
11 single product or a single static portfolio over
12 time.

13 MR. WASSERMAN: Thank you much. Dale?

14 MR. MICHAELS: You asked for perhaps
15 some language that would address procyclicality.
16 I would advocate something along the lines of a
17 clearly articulated framework that's transparent
18 and approved by the appropriate risk committee or
19 board. That way, folks know what it is. It has
20 gone through the governance process. People can
21 prepare for it.

22 Even with that, I would still argue for

1 the flexibility needed to address certain events.
2 For example, we talked a little bit about Brexit.
3 There have been government shutdowns. If you look
4 at the prescriptive measures that Amir has, the
5 three, longer volatility, the 25 percent, the 25
6 percent stress, none of them would have helped for
7 Brexit. We still would have been in the same
8 situation.

9 What you would prefer to do is think
10 about Brexit, look at past events, make sure you
11 have anticipated the type of volatility that could
12 happen, look at the applied volatilities, and have
13 some type of measured margin increases before the
14 event occurred, and if you are transparent to the
15 public as far as why you're doing it, folks can
16 plan for that, and the members could plan for
17 their liquidity purposes, the clients could plan
18 for their purposes, as long as we are transparent
19 with our thought process going into it.

20 MR. WASSERMAN: Dale, thank you very,
21 very much, for giving some concrete suggestions,
22 which are very helpful here and will be very

1 helpful in your comment on October 18.

2 Let me press on one point that you
3 raised. It seemed sort of interesting. Would you
4 see perhaps a distinction between say
5 idiosyncratic events and ongoing markets, so that
6 there may be just some different lines of
7 analysis, or do you think you have to keep it all
8 together?

9 MR. MICHAELS: That's why I would hate
10 to sit there and say procyclicality, well, we
11 implemented an Amir procyclicality and that takes
12 care of everything. I think there needs to be
13 some additional analysis done for these types of
14 events and give the CCPs the flexibility to react
15 to those events or better, rather than react to
16 them, anticipate them, and ensure your risk
17 measures, your margin, whatever it might be, your
18 add-ons, is anticipated in the possibility that
19 these events could happen, and the after effects
20 of what volatility may occur, what type of
21 pacemaker from those events is occurring.

22 MR. WASSERMAN: Thanks. Bill?

1 MR. DeLEON: Thank you, Bob. Bill
2 DeLeon, PIMCO. Two sort of unrelated streams.
3 One from previous comments. We sort of have a
4 different take on sort of the amount of data that
5 is available and the ability to calculate and what
6 we expect to calculate.

7 We do think there is a huge amount of
8 data available to us and our clients regarding
9 initial margin requirements on a security level or
10 derivative level, and the ability to calculate
11 things on an individual level.

12 When you get to portfolio margining
13 level, it would be nice to have better tools
14 available, however, you can compute and do certain
15 calculations, and you do get a lot of information
16 available. I do think there are pretty good
17 estimates out there, and there is information.
18 It's not perfect, but it's fairly good.

19 While we always want better information,
20 I do think there is a fair amount out there, and I
21 think of all the things I worry about, that is not
22 the biggest thing we worry about. I think there

1 is enough and you get what you need, and if you
2 are going to put a portfolio on, you can do enough
3 calculations to see how much margin you most
4 likely are going to need to post before you put
5 those trades on, and you can manage around that.

6 The other question you asked was sort of
7 measuring procyclicality and looking at that.
8 Unfortunately, there is no forward way to look at
9 it. It's a backwards looking problem. Nico
10 mentioned it, and we talked about Brexit and other
11 things. Those are all forward looking problems.
12 We can all sit here and guess, and part of my job
13 as a risk manager and many people's jobs, is to
14 think about things out of our mind and say hey,
15 this could happen or this could happen, and come
16 up with a stress test and try to predict it. A
17 lot of people do that.

18 The reality though is we get paid a lot
19 of money to do that, and sometimes we get it right
20 and sometimes we get it wrong, but a CCP or risk
21 management framework needs to be more robust.
22 Procyclicality or stress testing needs to be based

1 on backward looking stress testing checks.

2 That is why you look at a lot of these
3 backfilled data things, which is why you have
4 floors and you have 10 years of data, and you do
5 back testing things, to make sure your models are
6 not missing historical events or plausible events.

7 While people have talked about different
8 things using applied volatility, those are all
9 forward looking things. You need to use a
10 combination, and that is why a prescriptive or
11 overly prescriptive model will not work, and you
12 want to have a principles based model which is
13 tried and true, and you need to have one where the
14 board is accountable and there are a bunch of
15 principles the board has agreed to that they are
16 going to enforce and live by, run and check on a
17 regular basis.

18 MR. WASSERMAN: Thanks. Chris?

19 MR. PERKINS: Thank you. Getting back
20 to metrics, and I appreciate Bill's comments. If
21 you're sitting in Brexit and the 10 year point
22 drops by 30 basis points, and that automatically

1 triggers 90 basis points of margin being called
2 from a particular CCP, those are the type of
3 metrics that we really want to avoid.

4 Again, when you go back to a situation
5 like that, we want to look at the entirety of the
6 existing waterfalls to include initial margins,
7 skin in the game, and the guarantee fund. Is
8 there enough collateral within that waterfall to
9 withstand the 30 basis point move, because if it
10 triggers off a process of hyper collateralization,
11 then the other CCPs are going to have to get
12 moving, and that is where procyclicality takes
13 hold.

14 MR. WASSERMAN: I have Marnie and Nico.

15 MS. ROSENBERG: My additional comments
16 will be brief. One is one thing we haven't talked
17 about is haircuts and the ability to change
18 haircuts and the predictability on haircuts. I
19 think that is also very important when there are
20 large movements in collateral values.

21 The other point, Bob, I would make on
22 metrics is I think it is very simple. It's just

1 what have been the largest jumps over a historical
2 period, and calls for. Again, total amount of
3 collateral. To Chris' point, how much are you
4 calling from members and what are those
5 components, and do you see large jumps in certain
6 periods, and does that reflect some kind of issue
7 with the underlying margin model, like there are
8 not enough stress periods or there is not enough
9 of a buffer built in or a floor. Thanks.

10 MR. WASSERMAN: Nico?

11 MR. FRIEDMAN: I just wanted to make a
12 couple of points about back testing, which I don't
13 think we have covered yet. I think the guidance
14 could probably be strengthened in a couple of
15 ways. One is the guidance mentioned doing back
16 testing on actual portfolios.

17 Portfolios, when they are big,
18 diversified, when you look at it as a whole, could
19 actually hide some of the risk, so we would
20 recommend complimenting that with more contract
21 level back testing or even hypothetical portfolio.
22 That was the first point.

1 Secondly, back testing means a lot of
2 different things to different people. What we are
3 generally seeing consistently is back testing is
4 just checking daily P&L move or tracking daily P&L
5 move versus the actual amount of margin being
6 collected.

7 That is important such checking takes
8 place, but what happens is if you start seeing
9 some bridges, and I'm going back to the winter
10 2014 and energy markets, you see those bridges
11 accumulating and the magnitude of them increasing,
12 it's too late. Now you have to massively
13 recalibrate the initial margin, and for all the
14 reasons we explained, you can't do that overnight.
15 You are going to have to step it up over some
16 reasonable period of time.

17 What we would recommend is to enhance
18 the guidance around back testing and have CCPs
19 look back to specific stress periods and say okay,
20 not necessarily 2008, it could be sovereign events
21 or Brexit, here is my portfolio, if I move it back
22 to June 24, what would my initial margin model

1 have required versus the actual move, and doing
2 just more of a targeted back testing, if you will.

3 Lastly, just as a general comment, the
4 risk that we are most worried about is the one
5 that cannot be back tested easily, so liquidity
6 and concentrations. I know CCPs have a lot of
7 information that we don't necessarily have. For
8 example, around open interests, and that could
9 help us manage concentration at our single client
10 sort of account level, and conversely, we do have
11 information about liquidity, and our view on
12 liquidity of products in terms of stress, and that
13 is something that could be shared with CCPs as
14 they try to size initial margins, particularly for
15 the most non-linear less liquid buys.

16 MR. BANDMAN: I have a follow up
17 question for Chris Perkins, just a point you made
18 on this panel and the last one. I just want to
19 make sure we understand it.

20 Your comment was that a CCP should honor
21 the defaulter pays principle, but they should also
22 look to the waterfall before making the margin

1 call. Trying to reconcile those two ideas, is
2 your point that the clearinghouse should look not
3 just at the amount of IM that it holds, but also
4 at the potential defaulter's slice or contribution
5 to the default fund, or are you saying they should
6 look at the total risk mutualization available in
7 the waterfall in making that decision about
8 whether to call for more on margin?

9 MR. PERKINS: Thanks, Jeff, for letting
10 me clarify. Again, we believe in the defaulter
11 pays model. We believe the vast preponderance of
12 risk should be mitigated through initial margin.
13 We think that should be supplemented by robust
14 skin in the game. Together, those two elements,
15 and I know we are going to talk about this in the
16 third panel, should mitigate the vast
17 preponderance of the risk. That kind of model
18 best facilitates affordability, which is key to
19 systemic risk and systemic resiliency.

20 When we are talking about intraday
21 margin calls, obviously the vast preponderance of
22 risk should be mitigated through those two

1 elements. However, you also have a waterfall that
2 you are sitting behind. I think you can avoid the
3 procyclical nature of intraday margin calls that
4 stress the system and lead to a liquidity race to
5 the bottom potentially by recognizing all of the
6 assets in the waterfall. Again, you have to
7 stress the defaulter pays model.

8 Also, I made the point earlier, we need
9 to avoid these ad hoc charges that are outside the
10 waterfall, whether they are concentration charge
11 margin, et cetera, that is assessed directly to
12 clearing members because of the risk of clients as
13 an example. Very hazardous. Again, it is going
14 to impede affordability.

15 If an important client, a strategic
16 client, a risky client, or directional client, let
17 me say, is presented to me during a time of
18 stress, if they are generating stresses that I
19 have to mitigate because a CCP is charging me, I'm
20 not going to want to take that portfolio. It is
21 going to be expensive and risky for me.

22 We are also very concerned on these ad

1 hoc margin charges. Thanks.

2 MR. WASSERMAN: Chris, you segued us
3 into the last point. We have about 5 minutes
4 left. With respect to the rest of the guidance,
5 including in particular things like add-on
6 charges, do folks have comments? Hopefully,
7 fairly brief. Marnie?

8 MS. ROSENBERG: I would start by saying
9 that we agree with the guidance that
10 clearinghouses must use margin add-ons, but only
11 when they need to capture risks that may not be
12 captured in price histories or where there is
13 significant concentration within given positions.

14 I would note the public quantitative
15 disclosures do not require any disclosures on
16 add-ons. We don't have transparency on how
17 clearinghouses actually model this.

18 I think on the swap side, I am familiar
19 and involved in the surveys that are done with our
20 traders to provide insight into what those
21 liquidity add-ons should be, but as I said in the
22 earlier panel, when we have looked at

1 concentration of liquidity add-ons in the listed
2 segment, it is not consistent.

3 I would say it's not related to the
4 liquidity of the underlying contract. It is
5 really for the most part focused on sort of the
6 largest members, and sort of the margin multiplier
7 is added on.

8 I think more work needs to be done, both
9 in terms of developing kind of best practices in
10 this area, and also providing transparency to the
11 market. Thank you, Bob.

12 MR. WASSERMAN: Thanks. Dale and Sunil,
13 and Sunil will have the last word.

14 MR. MICHAELS: Just to clarify what I
15 think Chris was saying. We don't want to
16 necessarily restrict the add-on charges that a
17 clearinghouse can charge to the clients, it is the
18 add-on charges to the clearing member itself that
19 wouldn't apply to the client. Is that correct?

20 MR. PERKINS: Yes. We appreciate there
21 are risks that need to be incorporated and
22 mitigated, so if a CCP sees a lot of stress in the

1 system, we want them to mitigate that stress.
2 However, it should be mitigated through the
3 waterfall, particularly through initial margin.

4 We get concerned when there are ad hoc
5 charges allocated to client clearing members
6 because of the risk of another party, again,
7 getting back to defaulter pays.

8 MR. MICHAELS: From that standpoint, I
9 would very much be an advocate of you need to have
10 the clearinghouses come up with methodologies
11 where you look at the concentration of the
12 particular market, you look at the correlation and
13 correlation breaking, and adding that into the
14 total margin, and looking at liquidity charges
15 that might be added.

16 As long as that is transparent, it is
17 clearly articulated, hopefully it has also been
18 approved by the governing body of a risk committee
19 or board. That way, the members and the buy side
20 could see it, can anticipate for it. Hopefully, I
21 think that comes to what folks are looking for.
22 As long as we are able to measure it and respond

1 to it, we need to make sure that we have
2 flexibility to have those types of add-on charges.

3 MR. WASSERMAN: Sunil, we have about one
4 more minute.

5 MR. CUTINHO: Just to add to what Dale
6 was saying, flexibility is the key point here with
7 respect to add-on, not every add-on can be
8 statistically modeled. You need to take care of
9 event risk, as he talked about.

10 MR. WASSERMAN: Thank you very much. We
11 have come to the end of our second panel. We're
12 going to have a 15 minute break, until 12:05.
13 Unfortunately, we do not have the budget to give
14 you lunch, even though it is the lunch hour, but
15 instead, we will let you eat cake.

16 (Recess)

17 MR. WASSERMAN: We are now going to
18 begin our last and longest session, where we are
19 going to be covering: Governance, Transparency,
20 CCP's Contributions -- DCO's Contributions to
21 Losses and Recovery.

22 And so I'd like to start with

1 governance. And I should note the Guidance
2 provides that CCP's Board should have exclusive
3 responsibility for ensuring that the CCP's risk
4 management framework, including its margin system
5 stress testing framework are designed properly. I
6 should note that the intention is not that the
7 Board perform these detailed tasks themselves, but
8 rather that they take ownership of the
9 responsibility to ensure that those tasks are
10 performed properly. And so my question is, is
11 that guidance on the responsibilities of the Board
12 appropriate? Is it sufficiently clear?

13 So, I guess I will -- since we have a
14 bunch of folks eager to start, I will just go
15 around the table. I've got Scott, I've got Paul,
16 and --

17 MR. HILL: Okay. Thanks. So, Bob, I
18 think your interpretation of the intent is
19 appropriate. I absolutely do not believe that's
20 what's clear in the Guidance. I don't believe
21 that if any person that sat on one of our Board of
22 Directors read it, they would want to sit on our

1 Board of Directors any longer. Because I think it
2 reads as if they are responsible for the
3 day-to-day management.

4 Our view is that the Board is
5 accountable to determine the appropriate risk
6 frameworks, to set risk appetites, to ensure risk
7 model governance, but in all of those things it's
8 more an accountability versus a responsibility.
9 And so our primary comment is that we believe the
10 Guidance is very unclear with regards to the line
11 between what a Board should do, and what
12 day-to-day management should do.

13 MR. WASSERMAN: And I should note, you
14 know, as I've mentioned a number of times before,
15 in the written comments it would be most helpful
16 if you are clear on that, but as well, to the
17 extent, again, that folks feel comfortable to be
18 sent, I think you understand based on what I was
19 saying, where we are trying to go, if there's ways
20 to express that more clearly detailed suggestions
21 would help because, again, it -- Because what I'm
22 hearing you say is it may be more a failure of

1 expression than a disagreement as to concept.

2 MR. HILL: That's what we hope is the
3 case, and our comments will reflect how we think
4 it could have been said differently.

5 MR. WASSERMAN: Okay. In which event I
6 think I will go to Paul, Marcus, Bill D, and then
7 Kim.

8 MR. CUSENZA: Thank you very much, Bob.
9 So, I'm Paul Cusenza the CEO of Nodal Exchange,
10 and the wholly owned subsidiary, Nodal Clear. I
11 believe that the message, that responsibility
12 should be explicitly with the Board, is in fact
13 the right message. I think it should be with the
14 Board from a responsibility standpoint. But to
15 your point, Bob, with the feedback, and as Scott
16 noted from management and input, and I think that,
17 you know, part of the reason why I believe it
18 should be with Board, too, from a decision-making
19 authority perspective is that there's also other
20 elements here in the United States where, for
21 example, the Public Director representation with
22 greater than 35 percent public directors, and if

1 they are risk competent, et cetera, that provides
2 an important element.

3 I also believe though that's very
4 important to have the mechanisms for feedback from
5 the stakeholders, including the clearing members
6 and get both disclosure and feedback there. And I
7 think that one place I might go further than what
8 they said in the Guidance, is that I think that
9 feedback should -- from clearing members should be
10 available on a universal basis. And there's a lot
11 of discussion about committees, et cetera, but
12 then there should be universal representation of
13 the clearing members.

14 And I think individual clearing members
15 should have the right and the ability to have
16 their message conveyed to the Board, so the Board
17 is informed, but then ultimately the Board makes
18 the decision. So I think there has to be cleared
19 that one can inform the Board, but then the Board
20 makes the decision.

21 MR. WASSERMAN: Thank you. Marcus?

22 MR. STANLEY: Thank you. Yes. So, I

1 guess I'd just like to start since there wasn't
2 sort of the -- what one could call the External
3 Public Interest Group, representation on the
4 previous panels. Well, just sort of a general
5 statement about our perspective on this, which is
6 that we view clearinghouses as having a sort of a
7 critical public utility dimension, in terms of
8 their centrality to the market, and also in terms
9 of the dangers that would be created by
10 clearinghouse failure, and in terms of the level
11 and scope of externalities that are implicated by
12 clearinghouse actions.

13 So, we view people's trust, the
14 reliability of clearinghouses is an absolutely
15 central issue in financial regulation, and we are
16 very concerned about this sort of continual
17 statements by clearing members and by end users on
18 the buy side, that they do not have full
19 transparency into, or confidence in the
20 sufficiency of clearinghouse resources, or the
21 techniques used by clearinghouses for risk
22 management.

1 I mean JPMorgan in its 2014 papers
2 stated straightforwardly, market participants
3 cannot have full confidence in the sufficiency of
4 clearinghouse resources. So when we look at new
5 constate of papers and proposals, what we are
6 really looking to is, is there something
7 definitive in there that's going to bridge that
8 gap, and bring that confidence for clearing
9 members, for market participants, that they
10 understand the risk management methodologies of
11 clearinghouses.

12 And I have to say in this consultative
13 paper was, I would say, very principles-based, and
14 non directive, and sort of suggestive, and didn't
15 seem to lay out a disclosure methodology that
16 would definitively permit external validation and
17 checks, even by clearinghouse members on these
18 risk methodologies. There were a variety of
19 suggestions made to the Board in terms of what
20 they should consider disclosing, and that list was
21 -- it was a good list but it was very general.

22 What is meant by a methodology? You

1 know, is the methodology something that would
2 permit a quantitative analyst to add a clearing
3 member to really go in and provide an external
4 perspective on whether these margining models were
5 adequate? Not just in terms of broad parameters
6 like the margin creative risk but, say, in terms
7 of the correlation assumptions used for portfolio
8 margining, and so on. And I now that in these
9 international documents are often sort of
10 suggestive when they -- you know, you kind of have
11 to amplify the message in them, because they are
12 written suggestively, but maybe behind the scenes
13 they are more directive.

14 But I didn't really see anything
15 definitive in terms of the disclosure of the
16 specificity of disclosure, the specific directive
17 to allow clearing members to participate on the
18 relevant committees and the Board; the membership
19 of the Board, that would have brought me that sort
20 of security that this bridge is being -- or that
21 this gap is being closed.

22 MR. WASSERMAN: Thanks. Bill?

1 MR. DeLEON: Bill DeLeon, PIMCO. Thank
2 you very much. You know, we agree with your
3 statements and we also agree with Scott's comments
4 that the language is not clear, however, we agree
5 though that the concept is correct, that Board
6 Members should be an oversight, but not a
7 day-to-day management position. So, we would hope
8 that the language would be adjusted to reflect
9 that concept. We think that corporate governance
10 should be corporate governance, and it should not
11 be day-to-day management at the Board level.

12 MR. WASSERMAN: Thanks. Kim?

13 MS. TAYLOR: I think my comments are
14 consistent with comments that Scott has made, and
15 comments that Bill has made. Very clearly,
16 there's a problem with the language saying the
17 Board has explicit responsibility for, and then
18 enumeration of very detailed things. Like the
19 best example I think is the approval of removal of
20 a stress-testing scenario. It's a very detailed
21 day-to-day risk management decision. The Board --
22 or corporate governance principles, at least in

1 the U.S., allow for Boards to rely on the
2 expertise of management that they hire, explicitly
3 to perform the day-to-day management functions,
4 the expertise of the management is available on a
5 24/7 basis.

6 The Board is designed to function in an
7 oversight role, and that does not come across
8 clearly in the way that these requirements are
9 laid out. I'm glad to hear you open with the fact
10 that that was the intent of the group, but that
11 definitely is not the takeaway that almost anyone
12 would have from reading this document. So, I
13 think it's important to take the governance aspect
14 up a notch so that Boards are clearly providing
15 corporate oversights, strategic direction, policy
16 oversight.

17 MR. WASSERMAN: Thanks. I've got,
18 Eileen, Andres, Marnie and Roshan. And again, if
19 I mispronounce anyone's name, please correct me
20 and accept my apologies. Eileen?

21 MS. KIELY: Okay. Great, you have my
22 name right, so that's good. Picking up on some of

1 the comments, so we actually like a lot of what's
2 said in the governance, notwithstanding that it
3 does seem to sound like you are asking the Board
4 of Directors to actually execute some of these
5 things, but we do agree that the accountability is
6 the important piece here, and we like to see that.

7 I do want to say, in particular, very
8 happy to see in 2.2.18, that the duties of the
9 representatives or the participants they
10 represent, because we have not had that experience
11 in this handful of Boards that we've been invited
12 on to. We have not felt that our view as the buy
13 side and as a fiduciary has been welcomed in that
14 capacity. So, thank you for including that.

15 The one other comment I'll make is, the
16 other issue that we have found in our processes on
17 Boards is the nondisclosure agreements that the
18 individual is required to sign, makes it very
19 difficult for them to bring in the relevant
20 expertise at the organizations to really bring the
21 expertise that's needed to bear to the Boards and
22 the risk committees that we sit on. It very

1 important to realize that CCP risk is so
2 multidimensional that there's really no one
3 individual that can bring everything that needs to
4 be done to a particular Board. So, I just wanted
5 to make that comment.

6 Then the other thing that I wanted to
7 talk about was the disclosure and feedback
8 mechanisms, and this is going I think to what
9 Marcus was just talking about. And we would
10 agree, we want to see a lot more specificity in
11 how those would look. And, you know, I said this
12 last week when we were in one of these roundtables
13 in Europe.

14 But I'm a practitioner, I'm a credit
15 risk analyst, so I spend my days writing credit
16 risk reviews on CCPs. And in preparing for these
17 meetings I actually went back and looked at 10 CCP
18 reviews that me and my team have done the last six
19 months. And tried to categorize the follow-up
20 questions we had. There's 180 follow-up questions
21 we had from those 10 CCP reviews, and that's after
22 reading all of the disclosures that are available

1 publicly. Most of those, over 50 percent of those
2 were related to default funded margin.

3 So, while the disclosures are far better
4 than they were, say, even five years ago, due to
5 the PFMIs and the quantitative disclosures, at
6 which time we expect those questions would have
7 been more like 360, a lot more still needs to be
8 done. Specifically, we would actually like to see
9 the disclosures more standardized on the
10 quantitative disclosure front, and I absolutely
11 appreciate that many of the CCPs came together and
12 put together a standardized spreadsheet format,
13 although it's generally an unformatted spreadsheet
14 with 50 different tabs. We do appreciate that
15 there was some consistency, although not all CCPs
16 are following it. And so we do want to see some
17 more standardization on that front.

18 In addition to that, we recommend that
19 all the disclosures be reviewed by auditors at
20 least annually. I think the disclosures really
21 need to have the same standards that we put to our
22 bilateral counterparts, which would have an audit

1 system in place. And to be clear we recommend
2 that because we found errors in them, and we
3 brought -- whenever we find an error we would
4 bring it to the attention of the of the CCP, and
5 they are very thankful and, oops, okay, let's move
6 on. But that's not acceptable, so we would like
7 to see an audit standard introduced.

8 And then we would also like to see an
9 MD&A, our management discussion and analysis
10 introduced. I think one would say that the PF and
11 my qualitative standards are meant to be something
12 like that, but I think put the two of them
13 together to help us understand movements in the
14 qualitative -- in the quantitative disclosures.
15 Help us really understand the risks that are going
16 in place.

17 Again, nothing more than we get in our
18 bilateral counterparts, we are asking for a
19 similar type of disclosure. The last thing I
20 think we need to have is much more explicit
21 disclose on the risk to the end user. And I'm
22 sure we'll be talking about this in short order

1 here, but right now, customers are exposed to the
2 default of the CCP and I guarantee you that it's
3 not well understood by the end user. And so I
4 think those risks need to be very, very well
5 disclosed, up front to all the market
6 participants. And I'll leave it at that.

7 MR. WASSERMAN: Let me just press you a
8 little bit both for today, but as well for the
9 18th when -- with the written comments. Can you
10 give us more specific detail as to what you think
11 the guidance should say? You know, and as well
12 how much of this, you know, yes, I will freely
13 admit, and own the fact that PFMI and the Guidance
14 are principles based. How can we do this in a way
15 that essentially fits all sizes, addresses the
16 concerns that have been raised about
17 confidentiality? How, obviously, as I said at the
18 beginning this will -- You know, this document
19 will benefit by challenge, but ultimately we need
20 to figure out, okay, what can we say that would
21 accomplish the goals and do so in a balanced way?

22 MS. KIELY: I think there's two things

1 to that. I think, first of all, for us to really
2 get where we need to be we have to go beyond
3 what's in the disclosures right now, or in your
4 consultative documentation. And we probably need
5 to come together as an industry to figure out what
6 should this disclosure look like, right. But to
7 your specific question of what could be done
8 within this document, I think the disclosure of
9 risk to end users, that could certainly be
10 specifically outlined, and an audit requirement
11 can certainly be specifically outlined. Those are
12 the two things that I would suggest, for this
13 purpose, could be made.

14 MR. WASSERMAN: Great. Thank you much.
15 Andres? And then I'm sorry, I keep on getting
16 your name really badly mispronounced.

17 MR. FERNANDEZ: I don't think it was
18 that bad, really. I respond to a lot of things.
19 I won't go into that now. Thanks, Bob. Andres
20 Fernandez, at Bank of America Merrill Lynch. On
21 the risk side; we actually like the fact that the
22 Guidance does place explicit responsibility on the

1 Boards, and we also viewed it as an accountability
2 by the -- that they have to do the work, and I
3 think that that the angle that we've liked, that
4 potentially see it more pointedly discussed in the
5 Guidance, is around how, ultimately the Board will
6 rely on management, but also what is the place of
7 external experts as part of advising the Board in
8 its review of the management -- I'm sorry -- of
9 the risk framework of the CCPs, as well as, you
10 know -- And it goes into quite a level of
11 specificity, right, the responsibilities that are
12 outlined in the Guidance are, you know, margin
13 methodology, plus pro-cyclicality stress testing,
14 and so on.

15 So, that requires expertise, it's not
16 necessarily expertise that would be broadly
17 shared, or consistently shared across the -- with
18 members of the Board, and so we would like to see
19 potentially more guidance on how that -- what
20 mechanisms, and in what ways that would be
21 covered. And I think it also speaks to the point
22 that Eileen made about the nondisclosure. You

1 know, the fact that perhaps members of the Board
2 have one aspect, or one -- or expertise to bring
3 to the table. They can go back to their firms and
4 certainly rely on folks that are a bit more
5 analytical, or governance expertise, about what
6 are the limits given to the nondisclosure
7 arrangement. Thank you.

8 MR. WASSERMAN: Thank you. Marnie?

9 MS. ROSENBERG: Thank you, Bob. Marnie
10 Rosenberg, JPMorgan. I'm also supportive of what
11 the clearinghouse has said on the accountability.
12 When we looked at the back at the language from
13 the original PFMIs, it was more of a suggestion
14 that the Board have that accountability and we
15 like that it's now made an explicit requirement.
16 With that being said, I think there's some
17 specific expansion of the guidance in some areas
18 that we wanted to know the governance overall, but
19 first with respect to the Board.

20 The guidance suggests that the Board
21 obtain input or justification, scenarios both
22 margin methodology and stress tests from members

1 since it would impact them. We actually think
2 that the input from members should be much broader
3 than that. We believe the Board should have
4 explicit responsibility and solicit participant
5 input on many material risk matters, not just
6 stress testing and margins.

7 So, by that I mean, changes to
8 membership criteria, and that's a fault management
9 framework, the order of the waterfall, collateral,
10 eligibility requirements, new products in
11 particular being cleared, and this is -- You know,
12 we are at a point of inflection with the
13 non-cleared derivative margin roles we are seeing,
14 increased expansion of products and, you know,
15 more incentives to go towards clearing. So I
16 think product suitability is where we really need
17 to be more engaged with the clearinghouses on
18 this. And then the other thing I would say is,
19 just on the -- you know, provide -- the Guidance
20 we think we should provide direction on the scope
21 mandate structure composition, and objectives that
22 risk committee members.

1 I mean, Bob, we talked about this
2 somewhat last week, and there's a lot of
3 confusion. In particular about what is the role
4 of the Risk Committee member that is from a member
5 firm? And what I mean by that is, there is some
6 confusion as to just that person represent the
7 interest of their firm, does it represent the
8 fiduciary of the clearinghouse, or are they
9 providing market expertise.

10 And we believe it should be as the
11 market expert to provide input. And to Eileen's
12 point, we also believe that given that that person
13 may not have all of the expertise they should be
14 able to solicit input from others in the firm from
15 a confidentiality perspective, so they can
16 provide, you know, their best input to the forum.

17 And then the other thing I would just
18 say is, under member consultation process, and
19 this gets back to us being able to provide input
20 from a member perspective. There needs to be
21 forum where members can provide input, whether
22 these were through former working groups,

1 consultations, it should not result in the CCP
2 electing to use one of these forums, but there
3 should be some kind of a structure that allows
4 members to provide that.

5 And then there also should be some
6 disclosure provided that if the Risk Committee and
7 the Board chooses not to recognize or agree with
8 that member input and incorporate that into
9 changes, there has to be some kind of audit trail
10 around that. Thank you.

11 MR. WASSERMAN: Let me press you on one
12 point, because I remember there is the letter was
13 suggesting that essentially there should be two
14 separate mechanisms, both the Risk Committee and a
15 member organization, and I remember my reaction
16 when I was reading that, you know, as government
17 bureaucrats we are sort trained aversively to
18 avoid being overly prescriptive, and creating
19 overly complex requirements. Is there some way to
20 put something like that in the Guidance without
21 falling into that trap of creating just basically
22 something that is too bureaucratic and complex?

1 MR. ROSENBERG: So, my point was, from a
2 member stakeholder perspective, not all members
3 sit on risk committees, so if you keep them
4 completely separate, a risk committee is the
5 governance mechanism of the clearinghouse, and the
6 members that sit on those risk committees, even in
7 EMIR, EMIR says representatives from clearing
8 members should sit on the risk committees, but it
9 doesn't define what that role, what that
10 representative is.

11 You know, are they representing their
12 own views from a market expertise, do they
13 represent their firm's views. And we believe from
14 a risk committee governance perspective, they
15 should be representing the interest of their firm,
16 they should be providing expertise to guide the
17 clearinghouse to come to the best decision-making
18 for the market. Right?

19 So, separately from that we are not
20 being prescriptive as to what kind of form for
21 engaging the broader stakeholder community, we
22 just think that there should be some kind of

1 mechanism to ensure that the clearinghouse and the
2 governance structure receives appropriate input
3 from all stakeholders, and there be some sort of
4 oversight as to how that input is actually taken
5 on board.

6 MR. WASSERMAN: Okay. I have Roshan,
7 Lindsay, Kim, Nico, Bill DeLeon, and Christal.

8 MR. ROBERT: Roshan Robert from
9 Barclays. So, listening to Scott, his opening
10 remarks and then to Paul, and well moderated by
11 Bill here. I think there is a requirement for the
12 responsibility and accountability to be sort
13 delineated, and I think that that is a key point
14 right there. Although at least in one place
15 within the Guidance, the Guidance does speak about
16 delegation of authority to managements, so one
17 important point there.

18 And when mentioning the explicit
19 responsibility of the Board, there is an implicit
20 reference to the fact that the Board should have
21 the view of the CCP's risk tolerance, and in that
22 sense, you know, review the material changes to

1 products, services, et cetera, and periodically
2 review the risk management program as a whole.
3 So, that's sort of like all-encompassing, which
4 makes even more sense for the responsibility and
5 accountability to be sort of delineated.

6 One other point is that we believe that,
7 you know, the oversight and management of
8 operational risk within the CCPs cannot be
9 understated, and maybe those can be elaborated a
10 little more. And one other point around is
11 guidance related to the CCP's emergency powers, as
12 the discretionary authority available to the CCPs
13 and then emergency situation, this also can be
14 sort of, like elaborate a little more.

15 I do agree with Eileen's and Marnie's
16 point around the risk committee aspect, you know,
17 wherein the risk committee members from the
18 participants -- don't represent those participants
19 on the risk committee. You know, and at least in
20 one point of the Guidance, the Guidance does speak
21 for the fact wherein the risk committee members
22 represent the firm's views. So I guess

1 articulating that separately within the Guidance
2 may be key. Thank you.

3 MR. WASSERMAN: Thank you. Lindsay?

4 MS. HOPKINS: Like so many others, I
5 just want to say that we also agree that the Board
6 should be overall responsible for the risk
7 management framework. The one additional comment
8 I wanted to make actually goes to risk committees
9 as well. In the governance section there is very
10 limited reference to all risk committee
11 complaints, both at some of those more detailed
12 risk-related responsibilities, and we thought it
13 would be appropriate for some of those to go to
14 the risk committee to then report to the Board.
15 So we would suggest, I guess, a more explicit
16 recognition of a committee's role in those
17 governance responsibilities.

18 MR. WASSERMAN: Thanks. Kim?

19 MS. TAYLOR: I wanted to talk a little
20 bit more about this issue of whose views the risk
21 committee members represent. And Eileen, you made
22 the reference to 2.2.18 where it talks about the

1 representatives being able to provide the
2 perspective of their firm that they represent, and
3 actually I don't -- That's not the way we read
4 that, we read that as, that's one alternative for
5 getting commercial feedback from the current
6 members would be to let them represent their
7 commercial view on the risk committees. But there
8 are other mechanisms to allow for them to give
9 their commercial feedback.

10 And I'm kind of making a distinction
11 between the clearing members own views as a user
12 and participant in the market, should be solicited
13 by CCP's just as a nature of anyone who is doing
14 business would naturally want customer feedback
15 about the businesses that they are engaging in.
16 And I think that clearinghouses have various
17 mechanisms for obtaining that type of feedback,
18 and I'm a believer in the use of those of those
19 mechanisms, and that we should have them.

20 When it comes to risk committee
21 representation though, that is a very specific --
22 in most cases -- a very specific official part,

1 it's not the final decision-maker, because the
2 Board has ultimate accountability for the risk
3 management framework, and the risk management
4 policy decision-making, but the risk committees
5 are a very real element in the governance process
6 of most of the CCPs where they exist.

7 And in that role I think it's very
8 important that the participants on that risk
9 committee are acting in the best interest of the
10 mechanism, the systemic risk protection function
11 that the clearinghouse needs to provide, and
12 should be providing their market expertise as
13 individuals in accordance with making sure that
14 the system is as best protected as possible, not
15 providing the commercial views of their firm as to
16 one result or another.

17 And that is something that we make very
18 explicit in the way we structure our risk
19 committees, and it actually somewhat affects the
20 confidentiality requirements that we also require
21 of those participants. We get the feedback from
22 the commercial elements of the firm in other ways,

1 but for people sitting on these risk committees
2 they are performing a function that is not unlike
3 the function that a Board Member would perform in
4 certain aspects. And their kind of duty of
5 loyalty needs to be to providing the result they
6 are responsible for contributing to.

7 MR. WASSERMAN: So, I'm actually
8 thinking I'm hearing some degree of convergence
9 here, in the sense that I think there is agreement
10 that you are at least in some -- like in your
11 case, the risk committee does not represent the
12 interest of the members, it is this kind of source
13 of expertise, and then to the extent you want to
14 get the legitimate interest of the members taken
15 into play, you are going to need some other
16 mechanism, however it is specified.

17 MS. TAYLOR: Yes. We have other
18 mechanisms.

19 MR. WASSERMAN: Fair enough. And again,
20 remember we are not -- So, again, looking at it
21 generically and what we should be expecting, it
22 sounds like we should be expecting multiple paths

1 to achieve multiple functions. I think one
2 additional thing which may need further work, and
3 whether it's on our part or yours is an open
4 question, is solving this other problem, which is,
5 how can you best get the judgment of the members
6 of the risk committee, whose duty is, you know,
7 again, not to represent the interest of the
8 members, but to get more the clearinghouse as a
9 whole.

10 Given that some of the challenges may --
11 You know, no one can be a complete polymath, and
12 be able to have expertise in every area, and so
13 how can you best get the -- you know, the input
14 from the risk committee members to the extent that
15 there may be limitations. And I know there are
16 challenges with relaxing those limitations on
17 their ability to communicate with their colleagues
18 who may have -- you know, again, expertise in
19 different areas. Am I beginning to see the right
20 thing, or am I getting it wrong?

21 MS. TAYLOR: I think I've heard that
22 around the table, although I can only speak to our

1 own experience in this case, but there are
2 numerous occasions where the risk committee
3 members ask for the opportunity to share the issue
4 with other experts within their firm, and that it
5 is granted. It's just that it is -- it's a part
6 of the good governance process, that it is -- it's
7 not automatically a conduit to kind of commercial
8 feedback from the firm, it's a governance
9 function, and they are allowed to share the
10 information with risk management expertise, or
11 other types of expertise within the firm, but that
12 is a kind of disclosed and granted thing rather
13 than a free for all.

14 MR. WASSERMAN: Fair enough. Thanks.
15 Nico?

16 MR. FRIEDMAN: So, maybe let me try to
17 address your last issue, maybe slightly
18 differently. When I think about the largest CCPs
19 in the world, they have plenty of touch points
20 with our firm, to get commercial feedback, to get
21 risk feedback through the risk committees. And
22 the process today is more like the CCP takes into

1 account the feedback and sort of aggregate it and,
2 you know, came up with an overall view of, say,
3 our firm's position on the matter. I think what
4 we are asking when we are suggesting that is more
5 formalized member consultation process is, we
6 would want that overall comprehensive
7 institutional view on a risk matter, to come from
8 us ultimately.

9 So, in other words, we want to bring in
10 the commercial dimensions. We want to bring in
11 the risk dimensions, and risk is sometimes
12 frontline, train desk perspective, it's also an
13 independent risk perspective, or control side
14 perspective. We want to bring in funding views,
15 or views from our Treasury departments. People in
16 the concert that we are suggesting is just that
17 it's, give us information so that we can, through
18 our own internal governance process, articulate a
19 final view and cast sort of that perspective
20 through a formal process.

21 MR. WASSERMAN: So, I've got so far,
22 Bill D, Christal, Paul. And then I'd like to if

1 we could, start segueing into one of the points
2 that, Nico, that you raised, which is again, the
3 transparency. So, Bill?

4 MR. DeLEON: Thanks, Bob. Bill DeLeon,
5 PIMCO. I guess I would just make a simple analogy
6 going back to when we first started talking about
7 this. The way I view it is more of a traditional
8 corporate Board structure. You have a corporate
9 Board that has a responsibility to ensure that
10 functions are carried out. They may not be
11 subject matter experts, but their job is to make
12 sure that the various committees that do the
13 functional work, understand and are carrying out
14 the work, ask the appropriate questions, and are
15 either directly auditing or ensuring that there is
16 an audit group auditing that work.

17 And that is how I think things should be
18 structured. And if you look at -- I know
19 particularly because I work with CME very closely,
20 how they do things, that's their construct, and I
21 know that other -- exchanges at other things, and
22 I know from my experience with other Boards, in

1 particular at my firm, we are hired by Boards to
2 manage funds. The fund Board does not know how to
3 manage assets. The do know how to ask us
4 questions about how we manager our funds. They do
5 ask us questions about how we do risk management;
6 they do ask us all sorts of questions, they ask us
7 about the process.

8 They ask, are we doing the process
9 correctly, and that's how I think -- that's the
10 analogy I think you want have is, the Board should
11 be asking the right questions, they are
12 responsible for making sure people are doing the
13 right job, but they don't have to be subject
14 matter experts, they have to be sufficiently
15 knowledgeable, or get people who are subject
16 matter experts in, to make sure people are doing
17 the right thing.

18 MR. WASSERMAN: And so again, I think
19 there maybe, again, some convergence here. I will
20 note, when I look at the governance in the
21 document as it currently stands, there are
22 references to ensuring that things happen,

1 ensuring that the design is proper and
2 challenging. And as you are putting it, you know,
3 ask the right questions. Clearly there is room
4 for misunderstanding in the current language.
5 Clearly there is room for improvement. Some of
6 those concepts are at least partially there, and
7 so I guess the question is, and a question I hope
8 folks will answer on October 18th, how can we go
9 from where we are to get it right.

10 MR. DeLEON: Yeah. And I think, you
11 know, if you read it carefully, it's ambiguous,
12 and that's the problems, so depending on who you
13 are, you'll read it one way or another, and given
14 we like to live in a world where there is clarity.

15 MR. WASSERMAN: Indeed. And you know,
16 again, the purpose of this is guidance to give
17 greater clarity if it is just creating new
18 ambiguities, it's not fulfilling its proper
19 function. And the last thing I'm sure folks were
20 looking forward to is guidance on the Guidance on
21 the PFMI. So, yes, again, the desire is very
22 much, how can we get it right, get it unambiguous,

1 and get it proper? Okay. Christal?

2 MS. LINT: Christal Lint, OCC. I just
3 want to go back to something Kim said which I
4 totally agree with; which is that, you know,
5 running a business whether it's just CCP or any
6 other business as part of your practice of
7 business, you on a formal and informal basis, in
8 all different forums, and all different subjects,
9 seek and solicit the input of your clients. And,
10 you know, going back and looking attention 2.218
11 XXXsaid elsewhere as 2.2.18XXX, there's
12 flexibility in that provision.

13 You know, the FCC recently finalized its
14 PFMI rulemaking for -- covered clearing agencies,
15 which is the analogy to a SIDCO on the CFTC side.
16 And I think one of the benefits they had, because
17 it's been so long, is that it had the benefit of
18 taking into account on the dialogue, even this
19 guidance you could see embedded in their
20 discussion. And they are very focused on, you
21 know, making sure that the CCP take into account
22 all the different perspectives, but they are very

1 principle-based in their approach in terms of how
2 you might do that.

3 In terms of getting the various
4 different constituents within, for example, a bank
5 getting their perspective, you know, one of the
6 things that we are sort of -- that I haven't heard
7 considered, which is unique to the U.S. and not
8 Europe, is the SRO model, and the fact that there
9 is already a rule-filing process where there's
10 notice of public comment, and an opportunity for
11 the public and various different industry groups,
12 and various different segments of those industry
13 groups to comment on those rulemakings.

14 On the risk management front, you know,
15 most of those filings are 40.10 filings. So they
16 have to go through an even lengthier advance
17 notice process, and in addition to getting input,
18 you know, from the public on that, and getting
19 input from the regulators in the drafting process,
20 whom I believe are also taking into account the
21 concerns they are hearing from the constituents,
22 but that that's already factored in, and so it

1 sounds like -- I guess I'm trying to get at, and
2 it's not clear what the disagreement is or where
3 there's actually a gap, at least within the U.S.
4 CCPs in terms of this issue.

5 MR. WASSERMAN: Okay. One thing -- So,
6 I'm going to just sort of throw out again under
7 the table, because -- and I've been hearing some
8 of this, we've been sort of going between the two
9 concepts of governance and transparency. Let me
10 just toss, you know, onto the table the question
11 on transparency and hopefully both can start
12 gently moving down that path. The Guidance
13 provides that it the Board's responsibility to
14 establish a comprehensive disclosure and feedback
15 mechanism for soliciting views from participants
16 and other relevant stakeholders, to inform the
17 Board's decision-making regarding the CCPs risk
18 management framework.

19 And to this end, the Guidance provides a
20 list of information relevant to margin and
21 stress-testing frameworks that should be
22 disclosed, and suggests a number of ways in which

1 the CCP might solicit feedback from stakeholders.
2 Is that guidance with respect to disclosure, and
3 in particular with respect to margin and
4 stress-testing methodologies appropriate? How can
5 it be -- How should it be improved?

6 So, at the moment I have Paul, Marcus,
7 Sebastien, and Kim again, and I'll look around to
8 see if I missed anyone else.

9 MR. CUSENZA: Thank you, Bob. So, in
10 terms of -- One thing I want to at least focus on
11 is risk committee, which is the term that people
12 are using here, but I think it could mean
13 different things to different people. I would
14 like to have at least the Guidance was trying to
15 separate this concept of Board decision-making,
16 and then the mechanisms for feedback and
17 disclosure. In many cases you could actually have
18 two different types of risk committees, and that
19 should be of course up to the clearinghouse,
20 because the risk committee of the Board, which is
21 part of the Board decision-making process, part of
22 the Board responsibility, and its Board Members,

1 and there's also risk committees made up of
2 clearing members, where they are providing the
3 mechanism for the disclosure as well as the
4 feedback.

5 And particularly in that -- which I
6 agree with, but I think sometimes it's confusing
7 what people what mean when they are saying that we
8 are risk committee. If we are talking about the
9 feedback mechanism risk committees which I think
10 is a very valuable piece, I also agree with what
11 Marnie and Kim were suggesting, but I don't think
12 it should be -- I think it should be the market
13 expertise, that's really brought to bear there in
14 that committee format, and therefore I would
15 delete in 2.218 ~~XXX2.2.18??XXX~~ the parenthetical
16 prescription that it must be the commercial
17 participant perspective and not expertise in
18 general.

19 But I also agree, very much with what
20 Kim and Christal were saying about the mechanism
21 for having feedback needs to be there. And as I
22 said earlier, I believe every clearing member has

1 got to have a direct access to the Board to inform
2 them, if they can't even get it done in the
3 committee. Because the committee member is one
4 thing, but if you are not in agreement with the
5 committee, you've got to have a voice as a
6 clearing member to go to that Board, that Board
7 has got to hear the minority view as well, I
8 think, in informing them.

9 And so that when it comes to the
10 question of then transparency and other things
11 too, you know, I certainly believe in what you
12 said upfront, Bob, which is that principles-based
13 as opposed to being overly prescriptive. I'm a
14 big fan of principles, because things can be
15 different for different clearinghouses and how
16 they operated. And so when you talk about like
17 transparency, et cetera, that means some of these,
18 you know, tax items like 2.2.17 that gets really
19 specific in some of its text, and some other
20 areas, you know, they are really specific.

21 Like every time you meet with somebody
22 you have to keep a record of it, you know, so some

1 of that stuff I would stay away from and go more
2 to the principles-based theme, which I think on
3 that level, which I think many of us said up
4 front, this is okay, in terms of where the
5 guidance is, but I'll leave it at that level, so
6 there's that ability to have the flexibility when
7 appropriate.

8 MR. WASSERMAN: Fair point. I should
9 note in some cases, and again some of this may not
10 be clear about, and getting the challenge is
11 helpful. The guidance intends to give examples
12 versus prescriptions, but to the extent that that
13 is not coming through or, again, to the extent
14 where you are looking to say, well, no, that
15 should be an example, it should be a prescription,
16 having that in the written comments would be very
17 helpful.

18 MR. CUSENZA: Yes, I concur, Bob. Just
19 to clarify that, because it's wonderful to get
20 examples, right, because educational, it informs
21 people to really think about issues, so I love the
22 examples and the Guidance and all of that. But it

1 gets dangerous because then people start pointing
2 to that and saying, well, you must do exactly what
3 this says. So I loved when they used the words,
4 for example, should consider, and always a little
5 pause, like, what do they mean when they say you
6 should do this? Does should mean you must do
7 this? Or, what do they mean? Should consider
8 though that, hey, I get that one.

9 MR. WASSERMAN: Sounds good. Marcus?

10 MR. STANLEY: Yes. So, in my initial
11 comments I was kind of already getting to that
12 transparency issue, so I'll talk a little more
13 about that, but also, just generally on this
14 issue, what the Board is doing. You know, when
15 you said that you were reluctant to be too
16 directive or prescriptive with clearinghouses, as
17 sort of a general regulatory principle that one
18 should avoid being too bureaucratic. I think, you
19 know, clearinghouses, we all know this, but it
20 bears repeating.

21 There are just not ordinary market
22 participants because of their -- because of the

1 fact that the government mandates that people use
2 their services, because of their utility
3 character, because of market competition as a
4 mechanism of disciplining clearinghouses, can be
5 questionable in a lot of cases, it can have some
6 counterproductive effects.

7 So I don't think you can avoid certain
8 kinds of prescriptive elements in how you interact
9 with clearinghouses, and there is this sort of
10 flavor in the Board section here, that you are
11 kind of trying to pass off some of these tougher
12 questions to the Board to figure out. And I think
13 that's where some of this discussion has come up
14 here. You know, are you asking the Board to
15 actually do these very complex things? Or just be
16 responsible for ensuring that a process is being
17 carried through to do them?

18 Which is what, I think, Bill DeLeon
19 said, is the appropriate role of the Board, that
20 the other people are figuring out that certain
21 standards and processes have been set, and certain
22 kinds of technical experts are available, and the

1 Board is making sure that those are being engaged
2 in the right way. So, there is -- You know, when
3 you say the Board should have explicit
4 responsibility to assess and limit procyclical
5 changes, you know, that's a massively complex
6 technical challenge that we just discussed in the
7 last panel, and that's something that regulatory
8 -- margin models mandated by regulators are
9 critically involved with.

10 So, the Board can enforce these things
11 for you, but it's not going to make these
12 decisions. And then when we get to transparency,
13 you know, there is this language, there's a list
14 of many specific things, but then there's this
15 language, should do, should consider information
16 regarding, you know, these things. So, you are
17 kind of like saying, yeah, we know that this is
18 the terrain of transparency, but we are not going
19 to step in there, and set the actually
20 transparency framework; whereas, I totally agree
21 with Eileen that some kind of consistency and
22 transparency, and some kind of communal effort to

1 get together and set that transparency framework
2 would be very useful, and then the Board could be
3 responsible for policing that.

4 And, again, with the feedback mechanism,
5 the same kind of thing, you know. Instead of
6 biting the bullet and saying, okay, here is how
7 your members -- here is how you have to go your
8 members, here is the advice you have to get from
9 your members, this is what Marnie brought up. You
10 know, do your members get some kind of rebuttable,
11 veto here over certain kinds of things? Again,
12 that's kind of, the Board will set up the feedback
13 mechanism.

14 And just in terms of the personal
15 expertise of the individuals on the Board, you are
16 not going to have that depth of expertise, and I
17 think you've said that several times that you
18 didn't mean to hand that all off to the Board.
19 But, you know, I think the regulators stepping up
20 in some of these areas, is going to be necessary.
21 And I just want to add one other thing, just
22 because I wasn't on the last panel, so on this

1 pro-cyclicality issue. Is that okay?

2 MR. WASSERMAN: Go ahead.

3 MR. STANLEY: Okay. And that was this
4 focus on the initial margin in pro-cyclicality. I
5 think you can't look at just one portion of the
6 waterfall as it regards pro-cyclicality.
7 Pro-cyclicality is all about, it's our entire
8 waterfall with initial margin, create disruptions
9 in the market. So just because initial margin is
10 stable, doesn't mean that it isn't contributing to
11 pro-cyclicality, because if it's inadequate and
12 you push through the other parts of the waterfall,
13 that's a pro-cyclical problem.

14 MR. WASSERMAN: Sounds good. And again,
15 by the way, just for the record. We would have
16 been happy to have you on the first two panels,
17 just for that record. And also I apologize,
18 because I think I was probably unclear, the issue
19 not that we are unwilling to prescribe standards,
20 for CCPs as regulators. I think it's fair to say
21 that our regulations, indeed, do prescribe such
22 standards. Where we tend to be -- and at this

1 point I'll speak just for myself, where I tend to
2 be a little bit more concerned, is prescribing the
3 precise means of getting to those, of achieving
4 those standards.

5 And so I think it is important indeed to
6 set regulatory standards, where there may be some
7 distance, and is on this issue of how prescriptive
8 are you on the means to get there, and for my own
9 part, I think there are some advantages to placing
10 the responsibility on the regulated entity to find
11 its own way, adapted to its own particular
12 business model, and all the specifics there, to
13 achieve those standards. So they can't say, oh,
14 look, we did exactly what you said, and it didn't
15 achieve it, so sorry but you didn't ask us to do
16 that.

17 And to have, you know, again, ensure
18 that at the highest level of the Board, there is
19 ownership of that responsibility, so that you have
20 the Board, basically, taking the responsibility
21 for ensuring that management, who are the folks
22 who will have the direct expertise, in fact,

1 design systems, and have designed systems, that
2 will achieve the requisite goals. So I'm sorry, I
3 was sort of unclear on that.

4 I've got Sebastien, Kim and Marnie, at
5 this point -- and then Eileen.

6 MR. RENARD: Thank you. Let's respond
7 to your questions with regard to the guidance over
8 the Board's responsibility to establish a
9 comprehensive disclosure and feedback mechanism.
10 We believe that the guidance is very clear and
11 very appropriate, and that transparency is key.
12 We would like to emphasize the need for a very
13 formal Board process that is capable of
14 considering and incorporating the feedback from
15 key non-CCP stakeholders, including clearing
16 members.

17 I would believe that further work needs
18 to be done to establish a forum or vehicle for
19 this feedback group. I believe that stakeholders
20 should receive feedback in rational, positive or
21 negative on their proposals once they have been
22 considered by the Board. Separately we would like

1 also to note that there's a need for the CCP
2 approach to the confidentiality required of risk
3 committee members to be standardized.

4 Given that risk committee members are
5 included in the CCP process for the expertise and
6 then taking into account increasing virtue of
7 products cleared. The confidentiality agreements
8 should allow members to consult with other experts
9 at their firms in order to ensure that best risk
10 management approach at the CCP. On that note
11 we've been involved with a national regulator in
12 an effort to standardize such an approach, to
13 bearing -- reason of success. Thank you.

14 MR. WASSERMAN: Thank you. So, I've got
15 Kim, Marnie, Eileen, and after that can we perhaps
16 start moving on to CCP's contributions to losses.

17 MS. TAYLOR: Thanks, Bob. Just one
18 comment stepping back to the Board, responsibility
19 versus accountability issue, one of the last
20 topics that was talked about there, was the
21 importance of the Board as a challenge function to
22 management's decision-making processes, and the

1 more that you make decision-making at the
2 day-to-day level of Board responsibility, the more
3 you erode the value of the Board as a challenge
4 function.

5 So I think it's important that the
6 mechanism allow for the challenge function of the
7 Board to not be undermined. With regards to some
8 of the transparency issues, I think -- Eileen made
9 a good point early on that the industry has made
10 some very good steps toward having quantitative
11 disclosure set of documents; having taken the last
12 step of kind of making them more consistently
13 comparable, so they are easy for users to evaluate
14 across CCPs.

15 So it might be that some very valid work
16 could be done in that regard rather than starting
17 from the level of saying there is no disclosure,
18 and we need to start with a whole new disclosure
19 mechanism. It might be that by taking the
20 quantitative disclosure mechanism path, and just
21 standardizing it, we would get a long -- we are
22 already a long way toward where we need to be.

1 The other item I wanted to talk about a
2 little bit is -- and this was talked about a
3 little bit when stress testing was discussed on
4 the prior panels. There are risks in over-sharing
5 the details of things like stress testing. So we
6 need to be sure that we are setting the right
7 balance. I'm very sympathetic toward the clearing
8 member's desire, or the end user's desire to be
9 able to have something to evaluate the risk
10 profile of the clearinghouses that they are doing
11 business with, very sympathetic to that. But we
12 need to find a way to achieve that without sharing
13 so much detail about the mechanisms that are used
14 by clearinghouses that either people change their
15 behavior to kind of game the system, because they
16 know so much about the requirements.

17 People feel that the stress testing that
18 the clearinghouse does is like a safe harbor, they
19 don't then challenge themselves to do any further
20 risk management assessment on their own. I think
21 even some of the Fed Governors have made
22 statements about that, creating a risk of mano

1 culture, model mano culture, so everybody gets
2 dependent on the same exact set of risk models,
3 and if there's an error in that model, it's a
4 global error.

5 So, diversity in the models, and the
6 view points that are brought risk management
7 across the industry is actually a very good thing,
8 and so we don't want to -- we don't want to kind
9 of -- We don't want to create a safe harbor where
10 everybody figures, all I have to do is do what the
11 clearinghouses do, and I'm covered on risk
12 management, and nobody is then challenging
13 clearinghouses' models, to help models become
14 better over time, so there is a risk with the
15 over-sharing.

16 And then regarding your points about
17 allowing CCPs to establish mechanisms for the
18 transparency and feedback, versus prescribing
19 that, I very much like what you are saying about
20 that physiology, that is not what this document
21 says. This document is very prescriptive, much
22 more leans toward prescribing what clearinghouses

1 need to do versus setting kind of a principle that
2 says, clearinghouse Boards should establish a
3 mechanism for feedback to be considered. Or
4 should ensure that the management includes
5 customer feedback in the processes that they have
6 in place. Something that is in line with your
7 words, is not what's in this document.

8 MR. WASSERMAN: Let me press you just
9 very quickly on two points. You mentioned the
10 possibility of gaming the system, and I guess my
11 question would be, if in fact the risk evaluation
12 system is well defined, it's not clear to me how
13 people would game that if they essentially change
14 their behavior in reaction to that, wouldn't they,
15 if the system is well developed, well designed,
16 would be reducing risks?

17 MS. TAYLOR: Yes. If you look at it
18 just at one clearinghouse, yes. It's somewhat
19 different at a clearinghouse level than it is at
20 the bank level, because at the bank level they are
21 looking at the risk across their whole portfolio
22 of things, and some things might evaluated

1 differently in the risk models. In the
2 clearinghouse the risk that we face, is only the
3 risk of the positions that we face.

4 However, if everybody is kind of
5 prescribed to use the same models across the
6 different clearinghouses -- what we don't want is
7 people taking actions to use certain mechanisms in
8 the market that would temporarily show a reduction
9 in their risk profile, and then maybe their
10 options are going to expire or there could be --
11 Even the best designed models have blind spots,
12 and so you don't want to create a situation where
13 people can take action to take advantage of the
14 blind spots, and nobody is running any kind of
15 different model to assess that.

16 MR. WASSERMAN: Okay. And again, I'm
17 speaking not a regulatory prescribed model, but
18 essentially transparency as to this
19 clearinghouse's own model to its members. And I
20 know there's a concern around revealing individual
21 positions. And that is crucial that we don't do
22 that. I guess the question I would have is, if

1 you have dozens or, you know, in some cases
2 perhaps 100 or so, different scenarios, and you
3 are saying, okay here are all these scenarios, we
4 ran all of this, here is the worst across all of
5 those, it's not clear to me when -- you know, with
6 one scenario I can see how you could reverse
7 engineer. If in fact you have as I would think,
8 particularly at a multi-line clearinghouse, many
9 scenarios. It's not as clear to me how that
10 reverse engineering would come to pass.

11 MS. TAYLOR: Well, I think the concern
12 is that depending on how you read this document,
13 and how any one clearinghouse reads it now, is
14 going to be one thing. How any one clearinghouse
15 is forced to read it, based on how their regulator
16 reads it in the future and interprets it, and
17 imposes requirements on them, based on the
18 regulators read of it, is a different issue.

19 So, if you end up in a situation -- One
20 risk that we saw in the way that some of the --
21 particularly the stress testing stuff was written,
22 is that you could be in a situation where the

1 industry is looking to have everybody identified
2 it from X, we would say from X's name, but from X
3 is the same -- here's the result in scenario 1, 2,
4 3, 4, 10 at this clearinghouse, at this
5 clearinghouse, at this clearinghouse, that than
6 starts to give people an opportunity to figure out
7 who Firm X is.

8 And when something bad starts to happen
9 to Firm X, or to the country that Firm X is from,
10 or to the market segment that Firm X participates
11 in, it becomes one piece of information that then
12 people can pounce on and use to kind of create the
13 downward pressure, the stock price and viability
14 of Firm X. So that's the type of thing we want to
15 be sure we don't kind of over-disclose even in an
16 anonymous way people will make assumptions

17 MR. WASSERMAN: Thanks. Marnie?

18 MS. ROSENBERG: Thank you, Bob. First I
19 wanted to address Christal's point from before.
20 So, we believe that public consultation period is
21 a little late for getting member input from the
22 get go when something is being considered. So I

1 don't -- I think the public consultation process
2 is really important and serves a vital interest.
3 But I sort of see that the clearing member and
4 participants needing to provide that input in the
5 front end, because it does impact the capital,
6 first of all, that we contribute to the
7 clearinghouse with the default fund and our
8 assessments. So I just wanted to make that point.

9 On the quantitative disclosures, I agree
10 with Eileen that it really goes a far way, and
11 there are obviously differences in implementation,
12 we have to work on that. But when I looked --
13 when I relooked at the margin disclosures, I don't
14 think that what we are talking about here is far
15 more extensive than what's in the quantitative
16 disclosures; which really just asks for sort of
17 the key assumptions or parameters, but don't allow
18 us to fully replicate and understand the drivers
19 behind the margins.

20 So, we are very supportive and we were
21 happy to see the cooperation of requiring
22 methodologies, parameters, assumptions for stress

1 testing, and for margin. We need that again to
2 manage and measure our risk. The other thing I
3 would just point out and I think, Kim, this is
4 what you were alluding to in the annex, but the
5 largest uncollateralized stress loss for each
6 clearing member without identifying the scenario
7 or the clearing member, I've asked so many people
8 internally, there's just -- there's nothing that
9 we could do with that information in terms of
10 knowing who that would in the market or the
11 portfolios, or the sensitivities, we are just
12 looking to be able to understand the risk
13 distribution and being able to model our potential
14 risk in a crisis. That's all we are trying to do.

15 MR. WASSERMAN: Okay. I have Eileen,
16 Chris, Bill D, Christal, Marcus and Nico. At some
17 point we really do need, because we are running
18 out of time here, to get to skin in the game, and
19 I imagine there must be at least somebody around
20 the table who will be going to -- meant to discuss
21 that -- just saying. So, Eileen?

22 MS. KIELY: Well, I would love talk

1 about that, but I had a point that I wanted to
2 make first, which is addressing that this 2..2.18,
3 the participation on the Boards, there's a real
4 key difference I think we all need to understand
5 between the buy side participation on these and
6 the clearing member, and the CCP participation.
7 And we've talked about -- you guys keep talking
8 about the commercial interests.

9 The buy side pays fees to access this
10 infrastructure, so we sit on these committees as a
11 fiduciary for our clients, we are not there for
12 commercial interest of how we would profit from
13 any of these decisions. We are there literally
14 to manage risk on behalf of our clients. So, I
15 think the standard perhaps should be a little
16 different, and that's why I appreciated seeing
17 that. So I just think it's very important for
18 everybody to understand what our goal really is on
19 these committees when you make these comments.

20 MR. WASSERMAN: Chris?

21 MR. PERKINS: I guess we could start the
22 skin in the game discussion, if that's okay.

1 Thank you very much, Bob. We would like to see a
2 greater degree of guidance around skin in the
3 game, we think that it should be more clearly
4 defined. And we have a couple of principles in
5 mind that I'd like to share, as we think about how
6 to contemplate the skin in the game. First it
7 should be calibrated on the basis of a robust and
8 globally consistent, that's very important,
9 minimum standard that's based on analytical risk-
10 based framework.

11 It should dynamically adjust to the risk
12 in the system, just like all the other elements of
13 the waterfall. We think that there should be a
14 regulatory floor to ensure that the balance of
15 risk prevails if you have a model. And then we
16 also think that skin in the game needs to address
17 the hazards of pro-cyclicality, and you can do so
18 by looking at a backdated -- long-dated average,
19 you can look at introducing a cap. But we just
20 think there's a complete lack of guidance on how
21 skin in the game should be calibrated and we think
22 it's very important to have a clearly-defined

1 guidance for skin in the game.

2 MR. WASSERMAN: Thank you much. Bill D?

3 MR. DeLEON: I have to echo Chris'
4 point, and I think this is one of the few times, I
5 would say I actually want not principle-based but
6 I want prescription, and we firmly believe that
7 CCPs are fiduciaries, and they are not just
8 utilities, as Marcus said, they are more than
9 that. They have a fiduciary responsibility, and
10 they are commercial enterprises, holding vast sums
11 of capital.

12 As Jeff said, they have \$300 billion,
13 that is on a levered basis, so if you think about
14 how big a hedge fund that would be, and how many
15 hedge funds out there have \$300 billion, you would
16 all scratching your heads, going, well, that's
17 really big. So, my point, and I think several
18 people's point here is, we sit here and we think
19 about how much capital is put in, or required to
20 be put in, and there is no floor, there is no
21 minimum amount, and to us that is mind boggling,
22 that there is no predefined number in the

1 waterfall that comes before client assets, that is
2 required by regulation for CCPs and we believe
3 that this number should be set at a minimum.

4 Many people have written papers as well
5 as us. We believe that this number should be at
6 least 5 percent of the guarantee fund, and should
7 be fully funded, or it should be at least as big
8 as the third largest contributor, or at least \$20
9 million, and we are probably the lowest of people
10 who have written papers at this table. We believe
11 that this is something that should be prescribed,
12 and it should be for each waterfall, it should be
13 fully funded, and it should be before any client
14 assets ever get there.

15 And this ensures that the risk
16 management protocols are going to be fully robust,
17 and ensures that the liquidity process is going to
18 be robust as well, because when you have risk
19 management framework which requires that you
20 actually lose your own money out of your earnings
21 before you get to touch anybody else's capital,
22 you are going to be paying attention a lot.

1 You are not going to be relying on other
2 people's capital, you are not going to be calling
3 liquidity lines, you are not going to be coming up
4 with all sorts of interesting ways to go after
5 people's capital, and coming up with stories, you
6 are going to come with a risk management framework
7 that is really, really robust, and I just want to
8 stress that this is key to ensuring that CCPs are
9 resilient and do not fail, and if they do fail,
10 that the buck stops with the people who own it,
11 and which is the equity holders of the CCP. They
12 do not get to say they are market utility in
13 taking no risk. Because they are earning -- they
14 are earning fees for doing this job.

15 MR. WASSERMAN: Thank you. Christal?

16 MS. LINT: Yeah. Briefly, just back to
17 Marnie's comment. I want to clarify that when I
18 referenced the notice of public comment period, it
19 was assuming that as we discussed the CCP's were
20 already taking into consideration market views,
21 clearing member views through the risk committee,
22 and through the other informal mechanisms that,

1 you know, we engage with on a day-to-day basis as
2 we think about implementing things.

3 So to the extent that there seems to be
4 some concern about making sure the various
5 different perspectives within a bank, for example,
6 may be moved back into the CCP; you know,
7 something along the lines of the commercial
8 interests. Everything as a whole, I think then
9 that would be something appropriate for probably
10 notice and comment period, as opposed to coming
11 through the risk committees.

12 In relation to skin in the game, you
13 know, in theory there is no -- it's really hard to
14 oppose the fact that there should be an alignment
15 of risks, and the CCP is a risk manager for the
16 market. Focusing what I'll call my myopically on
17 a dollar amount, and focusing on skin in the game
18 and isolation, is sort of disregarding, I think,
19 all of the other things in the consultation, and
20 all the other regulatory requirements that are in
21 place.

22 When you start to think about the

1 requirements around governance, and the
2 requirements around bringing in the viewpoints of
3 direct participants and direct participants, other
4 stakeholders like settlement things. When you
5 look at it that way, I mean, you really are
6 already building in a system, where you are
7 accounting for all of those other interests, and
8 it's taking into consideration in the risk
9 management framework. If we didn't have all that
10 other stuff, I understand why it would be more
11 significant to start prescribing specific dollar
12 amounts, be that would serve as the only sort of
13 check in terms of, do CCPs have the right
14 incentives to get their risk management framework
15 correct.

16 MR. WASSERMAN: So just a couple of
17 things. I've got Marcus, Nico, Scott, Eileen,
18 Kim, Bill T, John D, and Paul. On the one hand,
19 we can go into a little bit of overtime, on the
20 other hand I would like to have at least a couple
21 of minutes at the end to at least very briefly
22 talk about recovery. So, Marcus?

1 MR. STANLEY: Thank you. So, just going
2 back to this issue just for a moment of
3 confidentiality and disclosures, you know, we are
4 in a world where all the major banks would include
5 most of the major clearing members are doing their
6 own stress tests, and the Fed is releasing all the
7 risk factors. You know, thousands of risk factors
8 for the trading books of those entities. And that
9 is not considered to be a confidentiality concern.
10 So, the idea that -- I would think that it would
11 be possible to do disclosures that protected
12 individual client, or individual member
13 confidentiality, you know, to a level certainly
14 that meets that standard.

15 And as far as skin in the game, we
16 strongly support clearinghouse skin in the game in
17 order to align incentives and agree with what
18 Chris said about the necessity for some kind of
19 floor on that. I mean, how specific that gets is
20 one thing, but if you are just giving a directive,
21 well you've got to have a dollar, you've got to
22 have some in there, that seems to lack

1 specificity. And just with respect to what Bill
2 said, certainly by saying that clearinghouses were
3 utilities, I certainly did not mean to imply that
4 they were not at the same time other things.

5 A lot of the complexities of our
6 situation as we've backed ourselves into a
7 situation where our utility entities are also
8 profit-making entities that owe duties to
9 shareholders; so that's a complex situation, and
10 squaring that up requires, I think, skin in the
11 game. I do think there's one extra thing to think
12 about in terms of skin in the game here, that on
13 the bank side of things, there's a lot of
14 attention to individual executive skin in the game
15 beyond even just equity-level skin in the game.

16 Because in bank resolution, Title II
17 Bank Resolution, the senior management gets fired,
18 and there is the ability to claw back bonuses, on
19 Section 956, there's the ability to claw back
20 bonuses as well. Here we are in a situation where
21 that we actually don't want the clearinghouse to
22 fail. Ideally we would like the clearinghouse to

1 recover and not be put into resolution. And of
2 course there are situations where there can be a
3 market systemic issue that's not anyone's fault,
4 and shouldn't be pinned on a particular person.

5 But if there is a risk management
6 failure at a clearinghouse, then there ought to be
7 at some point some management consequences and
8 perhaps even some looking back to prior funds that
9 were received. I just want to end, and that goes
10 along with saying there's a fiduciary duty.
11 Because if someone violates fiduciary duty there's
12 some legal liabilities, so I know that would be
13 controversial, but it does exist on the bank side,
14 it's been emphasized on the bank side, and I just
15 want to put it on the table.

16 MR. WASSERMAN: Thank you. Nico?

17 MR. FRIEDMAN: So, I'll be brief. I
18 want to go back again to transparency. And lately
19 there's been so much focus on recovery and
20 resolution of CCPs, that I'm worried that there's
21 a growing mistrust that the size of the funding
22 resources of the CCP and the shocks that the CCP

1 can weather. And that's why I think transparency
2 back to market confidence. You need the market to
3 be confident, and be there to support the CCP in
4 times of stress, and the way you achieve that is
5 transparency of stress testing.

6 And I think there's a spectrum of
7 disclosure days where we were five years ago, and
8 where we are today which is better, where we could
9 be in, you know, five years and get much more
10 granularity around loss distributions, and all
11 things. But, you know, there are simple things
12 just such as, like the point that was just made,
13 which is disclosing to the market, here is the
14 series of very specific, hypothetical, ad hoc
15 scenarios, that we are conducting on a daily basis
16 to ensure the adequacy of funding resources, just
17 that being known by the market to be helpful.

18 The Guidance talks about to be averse --
19 stress testing, just flagging some of the banks or
20 the shocks that can be withheld by default funds
21 also will be helpful. So that's all about
22 observable risk, and I think disclosure around the

1 non-observable risk, again, liquidity and
2 concentration of how the CCP sort of risk manages
3 those components is important.

4 And then finally, on skin in the game, a
5 concept that we've brought up, too, is there is
6 the notion of a second tranche of skin in the
7 game, which again, you know, would give
8 incremental incentives to CCPs to ensure that the
9 default are appropriately sized, and so that could
10 have a positive role as well.

11 MR. WASSERMAN: Thanks. Scott?

12 MR. HILL: I'll try and be brief,
13 probably unpopular. So, we, I think we are one of
14 the first if not the first to introduce skin in
15 the game, when we launched ICE Clear Europe back
16 in 2008, and it was strictly a commercial
17 decision. You know, we've heard, maybe it's the
18 third largest or 5 percent, EMIR says 25 percent,
19 CITI wrote a paper that suggested a calibration
20 which I interpreted as effectively the difference
21 between cover 2 and cover 3. Not a single one of
22 those measures are risk based, because the

1 clearinghouse doesn't bring risk. The clearing
2 members, the clients bring the risk, and that's
3 what the margins are intended to manage.

4 Every dollar of skin in the game that
5 comes in, that stands in front, is a means of
6 increasing the risk that the members and customers
7 can bring to the clearinghouse. So, to be very
8 clear, again, we were one of the first to
9 introduce skin in the game, we've gotten \$0.25
10 billion of skin in the game in today, but we do
11 that because commercially, we think our customers
12 want it there.

13 I will tell you that the next risk
14 decision that we make, that our risk committee
15 wasn't in support of will be the first. The next
16 risk decision that we make that our Board
17 disapproved of, or that a regulator said no to
18 would be the first. I disagree 100 percent with a
19 view that says that skin in the game somehow
20 aligns risk. Our risk is aligned by our
21 governance structure. Our risks are aligned by
22 our reputation, and the reason that there is no

1 way to determine what an appropriate calibration
2 is, is because the CCP fundamentally does not
3 introduce risk to the clearinghouse that manages
4 it.

5 MR. WASSERMAN: Scott, can I pres you on
6 that just a bit, because on the one hand I do very
7 much take the point that there is an alignment of
8 incentives through reputation, which I imagine
9 flows into things like shared products, but I
10 guess, isn't the risk that the clearinghouse
11 brings that to the extent the clearinghouse fails
12 in its charge, to manage the risk that these other
13 bring to you, that's essentially the risk that you
14 bring the risk of -- and forgive me, the work
15 failure is perhaps unduly harsh, but it is, I
16 think in this context, the best way of
17 communicating it. And so isn't the issue that
18 what these folks are saying is, okay, how can we
19 make sure that you are properly incentivized
20 beyond reputation to make sure that both, in terms
21 of risk management tools, margin, you know,
22 product selection, all of that, that the

1 incentives are aligned.

2 MR. HILL: They ensure it by
3 participating in our risk committees, which act as
4 a constraint on what we are able to do. They
5 participate in some cases, by being user members
6 of our Boards of Directors. They are able to
7 manage it based on the size of the positions they
8 choose to bring to our clearinghouse, based on the
9 willingness to support a new product that we
10 launched. There are any number of ways, that
11 people who participate in the markets we clear,
12 have an ability to regulate the risk that we
13 manage, and the manner in which we manage it.

14 MR. WASSERMAN: Thanks. I think I next
15 have Eileen?

16 MR. THUM: I think I'm going to stay.
17 So before we end -- So, it's Bill Thum from
18 Vanguard -- And I know it's not on the agenda, but
19 I just do want to touch a little bit on variation
20 margin gains here, and because it is the topic
21 that's being discussed, and there does seem to be
22 some consensus, that it is not an appropriate

1 approach to be used for liquidity or recovery, as
2 it potentially contributes to pro-cyclicality,
3 with participants terminating positions in advance
4 of risking their variation margin.

5 It creates potentially unlimited risks
6 for participants, and it's unfair, as clearing is
7 mandated, clear trading allows for enhanced
8 protections. The resolution at the end of the
9 default waterfall and following additional CCP
10 contributions and clearing the member
11 contributions, variation margin gains haircutting
12 could be considered, but regulators must first
13 clarify and mandate a workable approach that does
14 not unduly harm directional investors that only
15 have net gains.

16 Unduly harm hedge investors who might
17 experience stresses, if they are forced to forfeit
18 gains, and may thereby be unable to meet variation
19 margin calls to address position losses, and
20 clarify and mandate guard rails. Mandate specific
21 guidelines, including resolution authority
22 oversight, and no creditor worse off protections,

1 including status as a senior debt claim. The
2 other issue, I think as we continue to probe this,
3 is what do we really mean by variation margin
4 gains haircutting? What aspect of the gains is
5 going to be haircut? What would the approach be?
6 What protections are provided to those that lose
7 their assets? So, from a buy side perspective, I
8 just want to clarify for today that we are very
9 much against using variation margin gains here.

10 MR. WASSERMAN: Fair enough. Kim?

11 MS. TAYLOR: Thanks, Bob. I'm back on
12 the topic of skin in the game, and with all due
13 respect to my friend, Scott, sitting next to me,
14 we've had skin in the game in our rules since at
15 least the 1980s, I think since the 1970s, so we
16 were very early adaptor of the fact that the
17 clearinghouse needs to align its incentives for
18 good risk management in the system, with the
19 incentives of the clearing members, by having skin
20 in the game in default management process; so, a
21 big believer in the importance of that.

22 I do agree with what Scott said about

1 the people who actually bring risk exposure to the
2 clearinghouse though, are the clearing members,
3 and the clearinghouse has a duty to make sure we
4 are managing the risk of that, and there is
5 governance input into that process from the
6 clearing members. So, the concern that I have
7 about legislating too high, our contribution of
8 the clearinghouse in the risk mutualization or the
9 waterfall, is that it potentially dilutes the very
10 risk mutualization mechanism that is the
11 underpinning of what makes the clearinghouse a
12 successful system risk management, litigator.

13 The reason that clearinghouses have
14 worked overtime in crisis situations, is a
15 combination of the risk management mechanism that
16 they have in place on a routine basis, and the
17 mechanism that they have in place to manage a
18 default. And very important in that default
19 management process, is the viable participation of
20 the clearing members in helping to contain the
21 risk that the clearinghouse needs to offload. And
22 a very strong control and incentive for the

1 appropriate participation of clearing members in
2 that process, is the fact that they have funds at
3 risk if the process doesn't work.

4 So, with most risk management issues
5 there is a need to find the right balance, and I'm
6 not sure that kind of legislating a
7 one-size-fits-all approach to what skin in the
8 game has to be from clearinghouse is the best way
9 to find the right balance. To be between ensuring
10 that the clearinghouse has a strong incentive to
11 ensure there's good risk management and ensuring
12 that the clearing members have strong incentives
13 to participate in the default management.

14 MR. WASSERMAN: And Kim's mention of the
15 default management process is a really good
16 reminder to remind us all that we also want to
17 discuss at least briefly, recovery and the
18 guidance on recovery and what additional or
19 different things that needs to be in that context.
20 So with that in mind could I turn to John?

21 MR. DABBS: Yeah, I'm good. I'm not
22 going to get you there yet, I'm just going to just

1 get in the game one more time. So, I guess the
2 point that I'd like to make is a very simple one,
3 which is, there's fundamentally no difference
4 between a client clearing member, and a
5 clearinghouse. Neither of us brings risk. So the
6 clearinghouse doesn't bring risk but it brings new
7 members, and we don't bring risk by bringing
8 clients.

9 Because we don't risk, we are not
10 neutral, they are not neutral, so we are all
11 identical. The only difference between a client
12 clearing member, client clearing, I'm not talking
13 about the clearinghouse positions, but from a
14 client clearing perspective, the only difference
15 is we write a check that says we are good to our
16 last drop, but every single dime of capital in the
17 entity on the line, and clearinghouses do not.

18 It's just fundamentals in terms of the
19 facts of how it goes. And then, by the way, we
20 participate in recovery, we use our default fund
21 resources, we don't get equity, we don't get paid
22 back. So, I think it's just -- we are not a

1 holder in the recovery, so I just think it's
2 important to -- a lot of these were established
3 because we were -- they were non public, they were
4 utilities, they were used for all of our services
5 and we were all part owner, but now when we look
6 at the structure years later, we can all shake our
7 heads and say, ah, well, that's probably not how
8 we would have designed it. How do we start it
9 from different lens, but that's how it is.

10 Sizing, we can all debate sizing, but I
11 just think this notion that there is not risk
12 brought to clearinghouses, they get paid for
13 managing the risk, we get paid for managing the
14 risk, we provide the same services, just different
15 -- different users, but it's just a stream down
16 from top to bottom.

17 MR. WASSERMAN: Thanks. Paul?

18 MR. CUSENZA: Yes. Thanks. So I want
19 to talk about skin in the game also, but before I
20 do that, real quick because it gets to the point
21 of being overly prescriptive and the dangers of
22 it, because I want to come back to Eileen's

1 comment about 2.2.18, and my point of deleting
2 that was to remove the prescriptive dimension that
3 you must take on the viewpoint of the participant.
4 That doesn't preclude if I delete it, taking on
5 the fiduciary responsibility. And I think that's
6 the importance of flexibility, is that you don't
7 take on the fiduciary responsibility that's great,
8 but then don't prescribe that everybody else has
9 to do the same thing.

10 So taking that point about skin in the
11 game, so I share what Kim said, and I mean, skin
12 in the game is very old. It goes way back to the
13 beginning of clearing. And from that standpoint
14 it's the right model, and I think it's nice that
15 in 2.29 and 2.210 it prescribes that, in this
16 case, that you do have skin in the game for
17 clearinghouses, because that should be there.

18 However, while -- and I appreciate
19 Bill's comments by giving three different elements
20 about how you would define that, and we meet all
21 three of those requirements. But that said, I
22 don't think it should be prescriptive because

1 there's dangers in being prescriptive. I like the
2 way this sets it up, that says, here is the
3 motivation and incentives, the way you should
4 think about it and how you should address it, and
5 then I believe that it's the feedback mechanisms
6 that we have with our customers and with our
7 clearing members, that should be an active
8 dialogue, and they should express exactly what
9 they feel and how they feel about that.

10 And clearinghouses should be responsible
11 to that, and the clearinghouse is not responsible,
12 there are other places you can do business. But I
13 think there should be that, you know,
14 communication mechanism, because I think it's
15 dangerous to get too prescriptive, because one
16 model may seem to be the right model that works at
17 the moment, but may not be the best model all the
18 time, and you have to have flexibility.

19 MR. WASSERMAN: Okay. I've got Marnie,
20 Bill D, Stephen, Nico, Scott, Isaac; and then with
21 the truism that all good things must come to an
22 end, Isaac will, in fact, be the last word. So,

1 Marnie?

2 MS. ROSENBERG: Thank you. I'm not
3 going to get into the details on our views on skin
4 in the game. I think my representatives from my
5 peers and buy side said it very well. You know,
6 in our paper in 2014 our recommendation, after
7 actually a lot of analytical work that was done,
8 was the higher of 10 percent of the default fund
9 or the contribution of largest member to create
10 the right incentive, that everybody already spoke
11 to.

12 One point I want to make though is on
13 capital for non-default losses. And so currently
14 in the PFMIs there is a requirement of six months,
15 of wind-down expenses from an operating capital
16 perspective. And we do believe that's not
17 sufficient. We believe clearinghouses and their
18 parents should be fully responsible for any losses
19 that incur from a non-default loss perspective.
20 And I think as a market we don't have a lot of
21 transparency at this point as to how kind of
22 operational risks, cyber, all of these sort new

1 risks are being managed, and that they are
2 sufficiently well capitalized. And I'm not
3 suggesting they are not, I'm just saying that we
4 don't have a lot of transparency over that. We
5 don't believe that participants should be
6 responsible or bear losses from a non-default loss
7 event perspective.

8 Bob, you wanted to talk about
9 incentives, so I'm happy to provide our views on
10 incentives in the default management process. You
11 know, we believe incentives obviously play a
12 critical role in determining how market
13 participants will act leading up to the following
14 and default, and into all the stages of default
15 management. Now, a lot of attention is focused on
16 the incentives of clearing members, I just want to
17 make the clear statement that clearing members are
18 sufficiently incentivized to support CCP
19 resiliency, and avoid recovery and resolution.

20 The bottom line is, we don't want our
21 trades torn up, these are our largest exposures
22 from a credit perspective. And the replacement

1 cost of these trades, plus the non-bankruptcy
2 remote, I am at risk, should the CCP fail to
3 recover, is very, very large. And additionally,
4 the threat of not being paid variation margin owed
5 to us, which is currently in some of the rule
6 books, and the thought, again, of trades being
7 torn up, worries us the most.

8 We don't want to get to this point. We
9 want to minimize our losses to the default fund
10 and avoid any call on assessments at a time when
11 liquidity will be scarce. We don't participate,
12 and if we don't participate in our auction
13 effectively, we are hit first through
14 generization. So I think there's misperception
15 that I hear, that clearing member may be
16 incentivized to rig the auction by providing low
17 bids, or no bids at all, if they perceive that CCP
18 resolution, for example, provides a better
19 alternative?

20 For example, if clearing members were to
21 receive equity, or senior debt against their
22 losses, we just don't think this will hold up,

1 because clearing members would be taking a risk of
2 unpredictable losses, that way exceeds default
3 fund assessments, which may not be recouped from
4 any subsequent equity or debt claims.

5 So, I just want to make that clear that
6 we are well incentivized to participate in the
7 auction. Any kind of threat of our trades being
8 torn up, or the gains that were owed not being
9 paid to us, is incentive enough.

10 MR. WASSERMAN: Thank you. Bill?

11 MR. DeLEON: Thank you, Bob. At the
12 risk of getting into a bit of a debate, I did want
13 to respond to a few comments about the CCP market
14 and how things work in real life. It's a
15 monopoly. We have no choice but to use CCPs
16 because that's what the law says, so we have to
17 use them. The dealers dictate with CCPs we use,
18 we've tried voting with our feet, the dealers make
19 us pick where we want to go. There are limited
20 CCPs to go to.

21 We've spoken actively and often and they
22 haven't listened, so let's be clear, we've done

1 all these things, and we've given input and as
2 have many of our brethren, to risk committees
3 about what we'd like to see. Some of them have
4 listened, some of them haven't. We don't run the
5 CCPs, and this is why we are saying, we think
6 something prescriptive needs to be done, because
7 they are not market utilities, they manage the
8 risk and if something goes wrong, the concept that
9 they are paying out active earnings in dividends,
10 at the end of the day, after they've been paying
11 this dividend stream out, all of a sudden they go
12 bust, and they didn't have any skin in the game,
13 seems sort of backwards to us.

14 MR. WASSERMAN: Thank you. Stephen?

15 MR. BERGER: Thank you. Two quick
16 observations on the skin in the game discussion;
17 if you read carefully what's in the current
18 guidance the state of the objective of skin in the
19 game is to enhance confidence. So I think it is
20 -- you know, I guess the more people comment, I
21 think it would interesting if that's what they
22 actually think, that the primary objective is

1 whether -- because a lot of what I hear is a
2 discussion about how the CCP skin in the game
3 could act as a material loss-absorbing resource,
4 but it's not clear to me when you compare the
5 numbers that whether or not we would actually do
6 that.

7 So, if the true objective is to enhance
8 participants' confidence due to alignment of
9 interests, I think we should be clear about that,
10 and not overemphasize how much it's going to
11 contribute from the loss absorbing resources
12 angle. So just something I'd be interested in
13 hearing people's views on, although, obviously, we
14 don't have time to discuss that today.

15 The second thing I think is important is
16 that we need to be cognizant that any skin in the
17 game requirements are from what I call business
18 model agnostic. I think the driver of
19 profitability for different companies that run
20 CCPs is different. Some are, you know, very
21 profitable because they have, you know, vertically
22 a line to the exchange, that's a big drive of

1 profitability, but some CCPs are more kind sleepy
2 and boring. And so I don't want to create an
3 incentive for, you know, certain CCPs to have to
4 then go pursue a higher margin business lines to
5 meet certain requirements that aren't necessarily
6 relevant to what they want they wanted to do with
7 their corporate system.

8 And then finally, just because Bill
9 brought it up, I'll just echo his point on, I
10 guess, this form of recovery topic that variation
11 margin against haircutting does disproportionately
12 allocate losses within this community, and doesn't
13 appear to be fair, equitable paradigm for
14 allocating losses. So I think it's ill advised to
15 say in a core recovery business.

16 MR. WASSERMAN: Thank you much. Nico?

17 MR. FRIEDMAN: Yes. I just want to make
18 a couple of points on recovery. First of all we
19 agree with the guidance recovery, the recovery
20 tools that the CCP must develop have to be
21 comprehensive and effective. They should be
22 defined ex ante, we think they should be reviewed

1 by members, functional regulators, as well as the
2 resolution authority who should invest in
3 reviewing the playbook. It should be CCP led with
4 some oversight of the resolution authority.

5 If you think that the situations under
6 which we would get to that level, we would
7 probably have four or five, you know, large
8 financial institutions in distress, and the
9 resolution authorities' involvement is going to be
10 essential. But we think that resolution should
11 absolutely be the last resort, if there's real
12 threat to financial stability, or to the public
13 interest.

14 Now, in terms of recovery tools, we
15 could have a long discussion about this, but if
16 you go back to the principle of being
17 comprehensive and effective, if you earn through
18 the waterfall, that includes the skin in the game,
19 the collateral, the assessments, you know, to the
20 members, we used to have loss at that level,
21 losses need to go somewhere, and again, no one
22 wants to get there, but in our view, fashion

1 margin gains, haircutting is probably the least
2 bad option in terms of broad allocation of those
3 losses, and provide incentives for participants
4 who actually bid in the auctions and support the
5 default management process.

6 So, I understand why it is unpopular
7 because we don't want those losses to ever happen
8 at that level, but again, to us, it's probably the
9 most effective, comprehensive of the tools out
10 there.

11 MR. WASSERMAN: Thank you. Scott?

12 MR. HILL: Just quickly. I completely
13 agree with the point that was made. I do believe
14 skin in the game enhances confidence. And when I
15 say commercial, that's effectively how we think
16 about it. It's what the market expects and it's
17 what we do. What I was more objecting to is the
18 thought that it can somehow be defined on a risk
19 basis. And so, you know, we again, have a \$0.25
20 billion, and whether we were one of the first or,
21 you know, it's been done for 100 years, either way
22 the point is \$0.25 billion as a means of enhancing

1 confidence is something, commercially, we think
2 makes sense. So that's one thing.

3 The second thing, I completely agree
4 with Nico on the importance of being comprehensive
5 and transparent, in terms of the recovery and
6 resolution plans. Bob, you know, our team has
7 been doing a lot of work with you and with the
8 industry, at ICE Clear Credit, in terms of
9 developing a very robust recovery plan. I agree
10 the focus should be on recovery in every absolute
11 -- or every instance possible, but we do have to
12 work in resolution when recovery has failed.

13 And then the last thing I'd like to get
14 on the record with regards to non-default losses.
15 And I completely appreciate Marnie's point, you
16 know, if there are things that are cyber related,
17 operational related at a CCP, you know, that's on
18 us for doing a bad job. But the two most
19 significant, non-default loss, risk that exist are
20 around the depository institutions where we put
21 our cash at the end of the day, and the liquidity
22 that we might need at any given point in time.

1 And so the thing I'd like to repeat that
2 Dale said one of the earlier panels, and in case
3 the Fed is listening, is central banks can go a
4 long way towards helping with those issues
5 because, you know, two of our clearinghouses have
6 an ability to put cash at a central bank
7 overnight. You know, but we run six, and the
8 others don't have that same access. And I don't
9 know why that will be the case, because I think
10 with the commercial banking relationships that we
11 have when we hand that cash at the end of the day
12 to the commercial they turn around and put it in
13 the Fed.

14 So, I think having direct access for
15 CCPs to put the cash in the Fed, I think that is a
16 way to eliminate one of the two big risks that I
17 mentioned. The second one is, we take cash and
18 effectively government securities, that's what we
19 take, and so the concept of, in a liquidity test,
20 we can't consider U.S. Treasury to be a liquid
21 asset. It's inconceivable why that is the case,
22 number one. Number two, it's inconceivable to me

1 why a central bank wouldn't say, at a moment of
2 crisis, if you need to turn a Treasury into a
3 dollar, you are able to do that.

4 And again, that's not giving me broad
5 access to the window, let me bring chairs and
6 tables it's -- A U.S. Treasury becomes a U.S.
7 dollar at a moment in time. It fully -- haircut
8 it if you want, haircut the U.S. Treasury

9 percent, but give me the 20 cents to
10 deal with the liquidity on the moment. So, with
11 regards to non-default losses, it's a really
12 important topic, but I think there's a really easy
13 solution to the two biggest risks than are NDLs.

14 MR. WASSERMAN: Thank you. Isaac?

15 MR. CHANG: So, I guess the challenge of
16 going last is that it's harder to come up with
17 something original that hasn't already been said.
18 But maybe because there have been people who have
19 talked about not bringing risks so I do represent
20 an asset manager, and we do represent investors
21 who do take risks in the marketplaces, in the
22 clear derivatives markets. That said, we also

1 post a lot of margin and we pay a lot of fees, and
2 maybe just sort of echo a point that's already
3 been made, even though there is theoretically
4 competition in the marketplace which should govern
5 market practices, in practice there's really not
6 that much competition, there is not that many
7 choices.

8 I wouldn't go so, you know -- And I will
9 also sort of mention, you know, when you say that
10 neither clearing firms nor the clearinghouses
11 bring risks to the system, and I think by your
12 comments you acknowledge this is the case, but you
13 may not bring market risks to the same extent, but
14 you certainly bring a lot of operational risks.
15 And so it's harder to quantify, and I think that's
16 why people are struggling a little bit to put a
17 number on it, but I wouldn't want at least to go
18 without saying that I do think that there's
19 material risk of one form or another, at every
20 point in the chain, and certainly we do
21 acknowledge our piece of it, but I wouldn't want
22 it to sort of -- at least not bring it up.

1 On the last point on recovery versus --
2 and resolution, you know, look, in a resolution
3 scenario we certainly understand that everything
4 is on the table, but I think our main objection is
5 the arbitrariness of the distribution or the
6 allocation of losses. And again, to the points
7 that have been raised, you know, directional
8 investors who will have gains or losses and not
9 relative value or offsetting positions, would bear
10 the brunt of that burden, and there are
11 alternatives that could be considered that we
12 think would be more fair in that group. But that
13 with, I'll end it.

14 MR. WASSERMAN: So, I'd like to
15 recognize Jeff, for a couple of closing remarks.
16 Then I will say one or two very last things.

17 MR. BANDMAN: Thanks. Really, it really
18 has been a great, great discussion today. I just
19 want to kind of pick up and respond to and
20 reiterate on one or two. First of all in response
21 to Scott's comments, I'd like to stick up for the
22 Fed word -- if it's the right way to say it -- but

1 just two observations on that point. You know,
2 first of all, in fact, we have been in very close
3 dialogue with them through the process of issuing
4 and exempt order with respect to customer accounts
5 held by systemically important DCOs at the Federal
6 Reserve banks.

7 That order was issued over the summer
8 and those accounts are in the process -- we
9 understand that they are being submitted to Fed
10 Board for approval, and we hope that those will be
11 open very soon, so that customer funds from the
12 systemically important -- particulars can be
13 lodged at as one of the news articles put it, when
14 the order was issued on, you know, the world's
15 safest bank.

16 The second component of that, it
17 actually, as we understand it, it's not within the
18 purview of the Federal Reserve Board itself, to
19 authorize direct access for other DCOs to open
20 accounts there. That would require an Act of
21 Congress to authorize accounts for DCOs other than
22 SIDCOs at Federal Reserve banks. So that should

1 be borne in mind just to let the record reflect
2 that.

3 To iterate a couple of things that Bob
4 said, and Marcus raised the point I'm glad you
5 did, I mean, our regime under our statute and
6 regulations at the CFTC very much is prescriptive
7 when it comes to the safety and soundness of
8 clearinghouses, our regime of supervision,
9 examinations, risk surveillance and other
10 elements, we certainly are not shy about, you
11 know, making sure that that's the case, and I'm
12 glad you raised the point, so that could be clear
13 to everybody.

14 The focus of today's dialogue, of
15 course, is you know, with respect to enhancement
16 of the guidance, as we are between the
17 promulgation of the consultative paper and the
18 final version, and we look forward to your
19 comments. You know, in that regard, first of all,
20 I would like to, you know, very much thank the
21 participants. You've shown me very in-depth
22 having consideration review of the guidance in

1 your comments that reflected that at a very deep
2 level, and we look forward to seeing that in your
3 comment letters to enhance the guidance.

4 You know, I also have to give credit to
5 Bob who, you know, not only is he the Co-Chair of
6 the group that issued the report, but I have many
7 people regard him fairly or unfairly as one of the
8 coauthors of the Guidance; and I think he's has
9 shown today genuine concern to improve the
10 Guidance and solicit comments and feedback, rather
11 than just defend work that could be perceived to
12 be his, or partly his, so I really commend him for
13 that.

14 I also would like to reiterate one other
15 comment that Bob made which is that, you know,
16 certainly staff of a divisional clearing and risk
17 has been closely engaged in this process, and has
18 great interest in where the guidance will land,
19 and we will in due course, I think, be considering
20 whether it might be appropriate to incorporate
21 elements of this into our own framework.

22 But, again, to reiterate what Bob said,

1 you know, for these things to be binding upon at
2 least our DCOs we have a regime that is subject to
3 our statute and regulations, and so if we were to
4 go down that road, of course there would be -- any
5 proposal would be developed by staff with
6 appropriate input. You know, a rule proposal
7 would have to be adopted by our Commissioners
8 subject to full notice and comment at that time.

9 And with that, I'll turn it back to Bob.
10 And I do thank everyone.

11 MR. WASSERMAN: Thank you, Jeff. And
12 thank you very much for your kind words, about me
13 especially. Again, I should note, in fairness,
14 that the Guidance in fact is very much an ensemble
15 work, but on the other hand, I will reiterate the
16 fact that the guidance talks about improving work
17 product through challenging it, we've had some
18 very good challenge here today, and I very much
19 expect and hope for, challenge in the written
20 comments that will be submitted on October 18th.

21 And as again, to reiterate, the more
22 specificity you give us as to what you think

1 should be changed and where you think, in precise
2 terms, it should end up, not guaranteeing that we
3 will, in fact, obey in each case, because among
4 other things, I expect there will be some, shall
5 we say, conflicting comments. But the more
6 specificity we get, the easier it is for us to
7 give -- you know, give folks what they want and to
8 make sure that we are getting it right.

9 I would very much like to express my
10 very deep appreciation to the panelists who came
11 here today, and thank you very much for your hard
12 work here, and for your travel. I'd like to very
13 much express my appreciation to my colleagues who
14 made this whole thing possible. Heaven knows, I
15 didn't. And wish everyone a safe trip home. And
16 thank you very much.

17 (Whereupon, at 1:59 p.m., the
18 PROCEEDINGS were adjourned.)

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I, Stephen K. Garland, notary public in
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