

MEMO# 33140

March 1, 2021

February Meeting of CFTC's Market Risk Advisory Committee Meeting-Subcommittee Recommendations

[33140]

March 1, 2021 TO: ICI Members

Derivatives Markets Advisory Committee SUBJECTS: Derivatives

ESG

Investment Advisers

Trading and Markets RE: February Meeting of CFTC's Market Risk Advisory Committee Meeting-Subcommittee Recommendations

On Tuesday, February 23, the Commodity Futures Trading Commission's Market Risk Advisory Committee (MRAC) held a public meeting.^[1] At the meeting, the MRAC received reports from its Subcommittees on Climate-Related Market Risk,^[2] CCP Risk and Governance, Market Structure, and Interest Rate Benchmark Reform.^[3] The meeting also included a discussion about diversity, equity, and inclusion in the derivatives industry. The reports issued by the Market Structure and CCP Risk and Governance Subcommittees are summarized below.

Recommendations of Market Structure Subcommittee

The MRAC Market Structure Subcommittee issued two reports. First, the Market Structure Subcommittee issued a report recommending reforms to the CFTC's process for making a swap "available to trade," commonly known as the MAT process.^[4] The CFTC's trade execution requirement is governed by CFTC rules 37.10 and 38.12, which provide authority to swap execution facilities (SEFs) to make a MAT determination, thereby determining the scope of swaps subject to the trade execution requirement. Market participants, including ICI, have raised significant concerns about the current process.^[5]

The Market Structure Subcommittee made recommendations that would:

1. Provide the Commission with the authority through its rulemaking process to determine that a swap is "made available to trade." This Commission-initiated process would be in addition to the current MAT process, which relies on SEFs to make a MAT determination and submit it to the Commission for approval or self-certification under the Commission's Part 40 rules. The Subcommittee recommended that the Commission-initiated process include an opportunity for public notice and comment.

2. Enhance the criteria used when either the Commission or SEFs make a MAT determination. The Subcommittee recommended that the criteria in CFTC rule 37.10 be enhanced so that:
 - a. The “shall consider, as appropriate” standard for consideration is strengthened to “must consider;”
 - b. It is clear that all factors must be evaluated, rather than just one or a subset;
 - c. The number of SEFs that list the swap is added as a factor, and at least two SEFs must list the swap; and
 - d. A minimum amount of trading history is required (e.g., that a swap has been listed for at least 90 days).
3. Extending the length of time between when a MAT determination is made and when the trade execution requirement becomes effective from the current 30 days to 90 days;[\[6\]](#) and
4. Create additional avenues for certain existing MAT swaps to no longer be subject to the trade execution requirement, when and where appropriate. The Subcommittee recommended that a process be developed to remove a swap from being subject to the trade execution requirement, and that the process generally be symmetric with the process for making a MAT determination.

The Subcommittee also recommended areas for future consideration, including:

1. Creation of an industry advisory body to provide recommendations to both the Commission and SEFs as to swaps that should be added or removed from the scope of swaps subject to the trade execution requirement;
2. Further clarification regarding how MAT determinations should apply to “package transactions” that include a swap subject to the trade execution requirement; and
3. The implications of a temporary outage at one or more SEFs or a major market disruption for swaps subject to the trade execution requirement.

Second, the Market Structure Subcommittee issued a report making recommendations regarding the swap dealer landscape.[\[7\]](#) In particular, the Subcommittee recommended that the CFTC (a) exempt swaps that are exchange-traded and centrally cleared from the swap dealer registration threshold calculation, and (b) further explore additional modifications to the swap dealer regime to encourage additional liquidity without undermining its objectives or increasing systemic risk. These recommendations are intended to address concerns regarding the efficacy of the CFTC’s floor trader exception to the swap dealer definition.

Recommendations of CCP Risk and Governance Subcommittee

The MRAC Subcommittee on CCP Risk and Governance issued two reports. First, the Central Counterparty (CCP) Risk and Governance Subcommittee issued a report making recommendations on CCP governance and providing a summary of subcommittee constituent perspectives.[\[8\]](#) The Subcommittee made the following recommendations, reflecting areas of agreement among Subcommittee members:

1. Risk Forum to Obtain Input. A Derivatives Clearing Organization (DCO) should establish various channels (such as risk advisory working groups) to solicit and obtain risk-based views of market participants in the early stages of proposing changes that

could materially affect the risk profile of the DCO's activity and choose the appropriate means of soliciting views depending on the issue to be addressed. The Subcommittee recommended amendments to CFTC Rules 39.26 or 39.13 to provide for the establishment and operation of one or more market participant risk advisory groups, and to define "market participants" to include representatives from clearing members and end-users.

2. Risk Management Committees. Risk Committee members must have clearly defined roles and obligations regarding the interests they represent and must have the ability and expertise to perform their role effectively. Therefore, the Subcommittee agreed to support a codification of best practices for Risk Committees with amendments to CFTC Rule 39.24 to require that a DCO:
 - a. Have governance arrangements that establish one or more risk management committees and require the board of directors to consult with and consider feedback from the risk committee(s) on all matters and proposed changes to the DCO's rules, procedures, or operations that could materially affect the risk profile of the DCO, as well as the clearing of new products that could significantly impact the DCO's risk profile;
 - b. Establish and enforce appropriate fitness standards for members of each risk management committee;
 - c. Maintain policies to ensure that members of each risk management committee are able to provide a risk-based independent, informed opinion on all matters presented to the committee and perform their duties in a manner that supports the safety and efficiency of the DCO and the stability of the broader financial system and that each risk management committee includes representatives from market participants.
 - d. Maintain policies to ensure that membership of each risk management committee is reconstituted on a regular basis.

The Subcommittee report also summarized constituent views on several other potential recommendations on which there was no agreement between DCOs and clearing members and end-users. These potential recommendations included:

1. Requiring DCOs to conduct a consultation with market participants before filing any rule submission with the CFTC that could materially affect the risk profile of the DCO's activity;
2. Providing for a clearly defined process for DCOs to factor in risk-based feedback received prior to submitting a rule filing, and requiring DCOs to revert back to market participants to inform them if the DCO has determined to not incorporate their feedback and providing the rationale; and>
3. When implementing changes that alter the risk profile of a DCO's activity, require the DCO to provide clear documentation to regulators regarding the feedback received, DCO response/action, and rationale for accepting, incorporating, or rejecting the feedback.

Second, the CCP Risk and Governance Subcommittee issued a report making recommendations regarding CCP margin methodologies.[\[9\]](#) The report made recommendations across six key elements of a robust margin framework and also noted several areas for future consideration.

The six areas and related recommendations are:

1. Anti-Procyclicality. The Subcommittee recommended that the CFTC enhance its flexible approach to supervising how CCPs manage procyclical margin requirements that prioritizes the desired outcome of reducing procyclicality, not the specific means of reducing it. Supervisory expectations should recognize that CCPs may employ a range of tools to measure and manage procyclicality that are uniquely tailored to the products and markets it clears. The report noted potential tools that may be employed to measure and manage procyclicality.[\[10\]](#)
2. Concentration and Liquidity Add-Ons. CCPs should be allowed flexibility to apply margin add-ons that consider the impact of liquidity and portfolio concentration on expected closeout costs. The application of liquidity and concentration add-ons by CCPs should be based on market depth and position exposures and may consider a number of potential factors, enumerated in the report.[\[11\]](#)
3. Intraday and Ad-Hoc Margin Calls. The CFTC should promote the use of scheduled/predictable event-driven and routine intraday variation settlement cycles to prevent the accumulation of current exposures at CCPs as appropriate. In addition, CCPs should be allowed the discretion to manage intraday exposures with unscheduled/not predictable event-driven intraday margin calls, but only under limited, specified conditions, as enumerated in the report.
4. Margin Period of Risk. The report explained that the expected closeout period for a given product, *i.e.*, the margin period of risk (MPOR), is a critical assumption that a CCP must make in developing its margin methodology. When evaluating the appropriateness of a CCP's MPOR assumption, the Subcommittee recommended that the CFTC consider a list of principles, enumerated in the report, that are intended to reflect the account structure, market structure, and liquidity of the product.[\[12\]](#)
5. Pricing. The Subcommittee recommended that CCPs have a robust framework for determining end of day settlement prices and theoretical intraday pricing. The report enumerated a set of principles intended to ensure a robust pricing framework.
6. Transparency. The Subcommittee stated that CCP margin methodologies should be sufficiently transparent to market participants so they can understand how models react to certain market conditions for liquidity planning and risk management purposes. The Subcommittee noted that it plans to issue a position paper with recommendations related to transparency and disclosures at a future date.

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endnotes

[\[1\]](#) The webcast of the meeting is *available at* <https://www.wirestream.tv/customer/cftc/2021/02-23/>. Acting Chair Behnam's opening statement is *available at* <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement022321>.

[\[2\]](#) The report of the MRAC Climate-Related Market Risk Subcommittee is *available at* https://www.cftc.gov/media/5686/MRAC_Climate-RelatedMarketRiskSubcommitteeBriefingR

[eport022321/download](https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf). That report summarized the report issued by the Subcommittee in September 2020 on Managing Climate Risk in the US Financial System, which is *available at* <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>.

[3] The report of the MRAC Interest Rate Benchmark Reform Subcommittee, which summarized recent developments in LIBOR transition, is *available at* https://www.cftc.gov/media/5676/MRAC_InterestRatesBenchmarkReformSubcommitteeReport022321/download.

[4] The report is *available at* https://www.cftc.gov/media/5691/MRAC_MarketStructureSubcommitteeRecommendationsRegardingTheMATProcess022321/download.

[5] See, e.g., Letter to Mr. Christopher Kirkpatrick, Secretary, CFTC, from Dorothy M. Donohue, Acting General Counsel, ICI, dated Sept. 28, 2017, *available at* <https://www.ici.org/pdf/30889a.pdf>; Letter to Mr. Christopher Kirkpatrick, Secretary, CFTC, from David W. Blass, General Counsel, ICI, dated Aug. 17, 2015, *available at* <https://www.ici.org/pdf/29262.pdf>; Letter to Mr. David A. Stawick, Secretary, CFTC, from Karrie McMillan, General Counsel, ICI, dated Feb. 13, 2012, *available at* <https://www.ici.org/pdf/25910.pdf>.

[6] The Subcommittee recommended, however, that if a swap is removed from being subject to the trade execution requirement, that determination should be effective immediately.

[7] The report is *available at* https://www.cftc.gov/media/5696/MRAC_MarketStructureSubcommitteeRecommendationsRegardingTheSwapDealerLandscape022321.pdf/download.

[8] The report is *available at* https://www.cftc.gov/media/5701/MRAC_CRGSubcommittee-RecommendationsOnCCPGovernance022321/download. ICI's members and other market participants have made recommendations to strengthen CCP risk management, recovery, and resolution, some of which are reflected in the recommendations of the Subcommittee. See, e.g., *A Path Forward for CCP Resilience, Recovery, and Resolution*, *available at* <https://www.blackrock.com/corporate/literature/publication/path-forward-for-ccp-resilience-recovery-and-resolution.pdf>.

[9] The report is *available at* https://www.cftc.gov/media/5706/MRAC_CRGSubcommittee-DiscussionPaperOnBestPracticesinCCPMarginMethodologies022321/download.

[10] The report noted that the tools and overall framework adopted by CCPs to limit procyclicality should be transparent to market participants. It explained that FCM, buy-side, one CCP and independent voting members of the MRAC Subcommittee believe that such transparency can be achieved through enhanced global standards for quantitative and qualitative disclosures which could also be improved by the inclusion of product level breach disclosures for significant products.

[11] The report noted that FCM, buy-side, and independent voting members of the MRAC Subcommittee thought additional add-ons should be considered as part of the report, including jump-to-default, wrong-way risk, sovereign, holidays, and whether the underlying asset is subject to default such as equity and corporate bond cash and derivative instruments.

[12] The report noted that FCM, buy-side, one CCP, and independent voting members of the MRAC Subcommittee believe that minimum MPOR should be set at two days to align with the time needed to hedge, port, or liquidate a defaulted portfolio, while other CCP members believe that it is more important to collect customer margin on a gross basis rather than focusing on a minimum MPOR.

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