ISDA® Safe, Efficient Markets

August 7, 2015

Department of the Treasury/Office of the Comptroller of the Currency
Docket No. OCC-2011-0008/RIN 1557-AD43

Federal Housing Finance Agency
RIN 2590-AA45

Board of Governors of the Federal Reserve System
Docket No. R-1415/RIN 7100 AD74

Commodity Futures Trading Commission
RIN 3038-AC97

Federal Deposit Insurance Corporation
RIN 3064-AE21

Securities and Exchange Commission
RIN 3235-AL12

Farm Credit Administration
RIN 3052-AC69

Addresses listed in Annex I

RE: DOCKET NO. OCC-2011-0008/RIN 1557-AD43; DOCKET NO. R-1415 /RIN 7100 AD74; RIN 3064-AE21; RIN 3052-AC69; RIN 2590-AA45; RIN 3038-AC97; RIN 3235-AL12

FOLLOW-UP TO TELEPHONE DISCUSSION ON JULY 30, 2015 RE MARGIN REQUIREMENTS FOR UNCLEARED SWAPS

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") appreciates the opportunity to provide this follow-up to our call on July 30, 2015 about uncleared swap margin with representatives of the Prudential Regulators[2] (the "**PRs**"), the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**"). We set

1 Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

2 The Prudential Regulators are: Treasury Department (Office of the Comptroller of the Currency); Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Farm Credit Administration; and Federal Housing Finance Agency.

out below a discussion of the issues on which we feel more information may be helpful in reviewing the proposed rules (the "**Proposed Rules**") issued by the PRs and the CFTC.[3]

1) The Proposed Rules do not allow sufficient time for the call and collection of initial margin ("IM") or variation margin ("VM")

The Proposed Rules provide for collection of both VM and IM on the business day after the trade date (and the PR Proposed Rule could be read as requiring collection of VM on the trade date).[4]

We propose that a covered swaps entity (as defined in the Proposed Rules) (a "**CSE**") would be required to make a call for VM on the earliest date on which the VM can be calculated and responded to, which must be no later than two business days after the trade date. A CSE would have to make a call for IM on the earliest date on which IM can be calculated, which again must be no later than two business days after the trade date. The CSE would then be required to collect VM and IM after the call within the standard settlement cycle for the relevant type of collateral.

This amount of time for the call and collection is needed for the following reasons.

Time Zone Issues: Many firms trade products that are marked to market in multiple regions. An example would be an entity trading Australian, Japanese, EU and US interest rate swaps or cross-currency swaps. The products will be marked in their respective time zones, for example: Sydney close, Tokyo close, London close and New York close. The VM call will be the netted amount of the change in value of all of the contracts, and so can only be calculated once the trading books of the entity have closed in the last applicable time zone (which would be New York in the example above). The calculation will then be available to the operations team of the firm on the business day after trade date. For the margin call to be agreed between two firms, both operations teams must have performed the calculation.

For example, consider an Australian financial counterparty (with swap volumes below the IM threshold) with a euro trade versus a European financial firm. Based on Monday's closing value, the European firm will issue a margin call to the Australian firm on Tuesday at 8 a.m. CET. However, the Australian firm will be outside office hours for Tuesday and only able to agree to the call on Wednesday morning Sydney time. Although this example focuses on a specific cross-border trade, financial firms are generally "cross-time-zone" by virtue of products traded and it would be difficult to segregate trades subject to potential time-zone issues from those not. The issues raised by parties in different time zones are illustrated by the chart in Annex II.

Time required for call: A call for margin requires a party to calculate the amount of collateral, which will require time, especially for financial institutions managing a global book of trades. For IM (and, to a lesser extent, VM), data reconciliation prior to calculation of the margin call would facilitate the process and reduce the likelihood of dispute on the basis of differences in

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[3] PRs: 79 Fed. Reg. 57348 (Sep. 24, 2014); CFTC: 79 Fed. Reg. 59898 (Oct. 3, 2014).

[4] PR Proposed Rule: IM, § _. 3(c); VM, §_.4(a); CFTC Proposed Rule: IM: §23.152(a); VM: §23.153(a).

portfolio. Member analysis shows that the match rate in trade portfolios increases from 88% on trade date plus one business day ("**T+1**") to 99% by T+5.

Time required for collection: The Proposed Rules envision a range of collateral types, which includes debt securities issued by governments, central banks and corporates and equities included in certain indexes. The settlement cycles of these assets vary between same day (for example, cash) and T+3 (for cross-border settlement of Japanese government bonds). If a firm envisions using non-cash collateral, it must ensure sufficient unencumbered collateral is available in anticipation of a margin call. Additionally, the settlement location of the collateral may be different from the jurisdictions and office hours of the firm meeting the margin call (for example: US Treasuries may be used to settle margin calls by a European firm to a US firm).

We recognize that use of a tri-party custodian solution may facilitate T+1 settlement of eligible assets but this solution is not optimal for all entities who may prefer bilateral agreements with third-party custodians. Imposing a shorter time period would result in a potential constraint on the products utilized due to market practice on settlement timings.

In addition, we ask the regulators to recognize that CSEs do not control the posting by their counterparties, so a failure by the posting counterparty should not result in sanctions on the CSE as collecting party if the CSE has taken reasonable steps to arrange for collection.

2) No currency haircut should be imposed if IM is in the termination currency specified by the parties and if VM is in the transfer currency specified by the parties

The Proposed Rules impose an 8% haircut (the "**FX Haircut")** if the "currency of the swap obligation differs from that of the collateral asset."[5]

We propose that the FX Haircut should not be determined using the "currency of the swap obligation". Instead, the FX Haircut should be determined using a termination currency (for IM) and a transfer currency (for VM) to be specified by the parties. The FX Haircut would therefore only be applied if the termination currency or the transfer currency, as designated by the parties, differs from that of the collateral asset.

Determining the FX Haircut by using the "currency of the swap obligation" raises several problems. A swap obligation, such as a cross currency swap, may have cash flows denominated in different currencies. Moreover, the margin is established on an aggregate basis for a netting set of swaps and swaps within the netting set may be denominated in different currencies. The currency of any given cash flow within the netting set may not be the best indicator of the currency risk faced by any one counterparty. In contrast, a termination or transfer currency that is specified by the parties would be a clear standard and the parties could specify a termination and transfer currency based on the applicable currency risks. Use of a termination and transfer currency would also be consistent with the approach taken in other regulatory contexts: the EU regulators, in their recent swap margin proposal, provide for an FX Haircut determined by the

[5] Proposed Rule: CFTC: §23.156; PR: this text was omitted from the haircuts listed in Table B in the Federal Register, but this omission appears to be unintentional and the text was included in Table B in the draft Federal Register notice.

termination and transfer currencies specified by the parties.[6] The Basel III leverage ratio uses the concept of "currency of settlement" as specified in the relevant derivative contract.[7]

In addition, each party should be able to specify its own termination and transfer currency (and the rules should not require a single termination or transfer currency for a counterparty pair). This is important because there are funding challenges if firms are forced to post in a termination or transfer currency which does not match what is available to them.

For example, for a Japanese entity posting IM in Japanese government bonds ("**JGBs**"), the termination and transfer currency should be Japanese yen ("**JPY**") rather than US dollars ("**USD**"), which is likely to be the default termination and transfer currency for US-based dealers. In this scenario, the Japanese entity would post JGBs and the US entity would post US Treasury securities ("**USTs**"). If the agreement specifies USD as the termination and transfer currency, then the US entity would not be able to accept JGBs without imposing the additional 8% haircut on the collateral posted by the Japanese entity, and the Japanese entity would have higher funding costs if it delivered USTs.

To avoid this, our proposal would be to permit parties to designate a termination and transfer currency for each party that can match the collateral they are expecting to post. Continuing our example, we would designate the termination and transfer currency as JPY where the termination amount (before applying any IM) was payable by the Japanese entity to the US entity, and USD where it was payable by the US entity to Japanese entity.

The definition in a Master Agreement may allow firms flexibility in the termination currency: for example, many existing Master Agreements provide that the termination currency is a currency to be specified from a defined range after an event of default. Firms should have the same flexibility in relation to the respective termination currencies for purposes of the FX Haircut. If not, it will be necessary for each party in a pair to designate as its respective termination currency for IM purposes a single currency from the range which they would be permitted to designate as a termination currency under the Master Agreement.

3) Segregation requirements should not apply to IM that is not required to be posted or collected under the margin rules.

The Proposed Rules provide that a CSE that posts IM, even if the IM posting is not required, must segregate such collateral at a third party custodian.[8]

CSEs should not be required to segregate IM if the IM is not subject to mandatory posting or collection. The policy rationale for the margin rules does not justify such segregation because

[6] Second Consultation Paper on the draft regulatory technical standards (the "**Draft RTS**") on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Art. 11(15) of Regulation (EU) No 648/2012, Annex II, Para. 6.

[7] Basel III leverage ratio framework and disclosure requirements, January 2014, p. 4, available at: http://www.bis.org/publ/bcbs270.pdf; BIS, Frequently asked question on the Basel III leverage ratio framework, October 2014, p. 1.

[8] Proposed Rules: CFTC: §23.157(a); PR: §__.7(a) .

the margin rules do not require such collateral to be posted or collected. Moreover, Section 4s(l) of the Commodity Exchange Act, adopted as part of the Dodd-Frank Act, provides for optional rights of segregation of collateral under certain circumstances, and there is no indication of any Congressional intent to expand segregation requirements beyond that required by Section 4s(l) for margin that is not required under the margin rules. The EU regulators, in their proposed margin rules, do not impose any requirements on margin that is not required to be posted or collected.[9]

4) CSEs should only be required to post margin after the appropriate times for calls and collection of collateral and after the counterparty agrees to receive the margin.

The Proposed Rules require posting of both VM and IM on T+1 (and the PR Proposed Rule could be read as requiring posting of VM on T).[10]

This time frame should be adjusted to allow time for calls, collections and acknowledgement by the counterparty. We propose the following: a CSE should have an obligation to give a notice to its non-CSE counterparties of the required margin posting, and such notice must be given on the earliest date on which margin can be calculated, which shall be no later than two business days after the trade date. After the counterparty notifies the CSE that it can accept the margin, the CSE will then deliver the margin within the standard settlement cycle for the relevant type of collateral.

As discussed above, the calculation and delivery process requires a timeframe of up to T+2 for calculation plus the standard settlement cycle for delivery. In addition, if a CSE is posting margin, it will be unable to deliver unless the counterparty is prepared to receive the margin. Unless the counterparty has taken appropriate steps to receive the margin, the settlement agents of the counterparty (such as the receiving bank or custodian) will not accept delivery. As a result, the timeframe for posting margin must include the time needed for a response from the receiving counterparty.

5) Eligible collateral for VM should include non-cash collateral and cash in any currency.

The Proposed Rules currently limit VM to cash collateral in USD or the settlement currency for payment obligations under the swap.[11]

Limiting eligible collateral for VM to cash is not necessary and places undue burden on parties that do not carry large cash positions in the ordinary course of their business. Many market participants that use swaps do not have large amounts of cash available for VM: for example, pension funds and insurance companies generally do not hold large amounts of cash in their investment portfolios. Requiring VM to be posted only in cash may affect risk management strategies and disincentivize parties from managing their asset positions efficiently. Risk in non-cash assets may be mitigated by limiting the scope of eligible collateral to high quality, liquid

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[9] Draft RTS, Recital (1).

[10] PR Proposed Rule: IM, § _. 3(c); VM, §_.4(a); CFTC Proposed Rule: IM: §23.152(a); VM: §23.153(a).

[11] Proposed Rule: CFTC: §23.157(b)(1); PR: §_.6(a).

assets. Appropriate haircuts for non-cash collateral provide protection against credit and other relevant risks.

In addition, cash in any currency should be eligible collateral for VM. Some market participants will have access to cash in some currencies but not others.

Both the BCBS/IOSCO and the EU regulators propose that eligible collateral for VM include non-cash collateral and cash with no limitation on the currency of the cash.[12] We ask that the final rules permit non-cash collateral and cash collateral in any currency for VM.

6) No haircuts should be imposed on cash VM or IM in any currency.

No haircut should apply to cash posted as VM or IM, regardless of the currency of the cash. Cash can be readily liquidated and therefore issues about the timing of liquidation do not arise for cash as they do for securities. The EU regulators, in their recent swap margin proposal, do not require haircuts for margin in cash.[13]

7) The test for determining affiliation and consolidation should be an accounting test that is consistent across the US and non-US margin rules.

The proposed margin rules issued by the CFTC and the PRs use affiliation and consolidation tests for purposes of thresholds and the cross-border application of the rules.[14] The EU uses a corporate "group" test for purposes of thresholds.[15] The tests used by the regulators are not consistent. In its recent cross-border proposal, the CFTC defined a "foreign consolidated subsidiary" ("**FCS**") as an entity in which a US parent entity has a controlling financial interest under US GAAP, such that the subsidiary is consolidated in the parent's financial statements under US GAAP. In contrast, the test used by the CFTC (except for the FCS definition) and the PRs is based on control, which includes ownership of more than 25% of the voting securities of a company. The EU proposals use yet another test, based on a determination of subsidiary status, which is established by several factors, including majority ownership.

We urge the regulators to adopt the accounting consolidation test throughout the margin rules, so that the test for group treatment is the same for purposes of cross-border application and for thresholds (and the test for thresholds will need to recognize non-US accounting for non-US parents). In addition, we ask the US regulators to work with non-US regulators to encourage the adoption of this test outside the US as well.

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[12] Basel Committee on Banking Supervision ("**BCBS**") and Board of the International Organization of Securities Commissions ("**IOSCO**"), "Margin requirements for non-centrally cleared derivatives", March 2015, available at: http://www.bis.org/bcbs/publ/d317.pdf at pp.16-17; Draft RTS at Art. 1, LEC p. 38.

[13] Draft RTS, Annex II, Table 2 VA (5).

[14] Proposed Rules: Definition of "Material Swaps Exposure" and "Initial Margin Threshold Amount"; PR Proposed Rule §_.9; and CFTC: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross Border Application of the Margin Requirements, 80 Fed. Reg. 41376, 41386.

[15] Draft RTS, Art. 6 GEN (1), Art. 7 GEN(1)

The accounting test is preferable to other measures because (as stated by the CFTC) it provides "a clear, bright-line test".[16] Corporate parents that prepare consolidated financial statements will readily know which entities are part of their group. Other entities will be able to use well-established accounting principles to make the determination. In addition, the control test (with a 25% limit), which has been developed in the context of bank regulatory requirements, may not be familiar to entities other than banks and their affiliates. It is also not appropriate for the margin rules, which are intended to address credit risks. For example, if an entity makes a passive investment in 30% of the equity of another company, then swap credit exposure to the investor should not be automatically aggregated with swap credit exposure to the equity issuer.

Moreover, consistency in determining consolidation is of great importance to ISDA members. The largest CSEs have tens of thousands of counterparties. Threshold status must be determined for all counterparties other than corporate end-users. Therefore, having a single consistent bright-line test is invaluable in establishing which counterparties must post and which rules apply, both inside and outside the US.

8) The documentation requirements are burdensome and duplicative of existing rules.

The Proposed Rules require the trading documentation to specify methodology and inputs used for valuations in calculating VM (for the PRs) and VM and IM (for the CFTC).[17]

This rule should be removed because documentation is already addressed under regulations applicable to CSEs. CFTC Rules 23.504(b)(4)(i) and (ii) require swap trading relationship documentation to include "methods, procedures, rules and inputs" for swap valuation and a valuation dispute resolution process. Also, CFTC Rule 23.431(d)(3) requires disclosure of "the methodology and assumptions used to prepare the daily mark". Given these rules, it is duplicative and unnecessary for the regulators to impose additional documentation requirements related to valuation.

In addition, this proposed documentation requirement will raise difficult implementation issues when applied to IM. The method used to calculate IM may be a complex model. Such a model, which is subject to regulatory approval, may be based on proprietary methodology and it may not be appropriate to include such a model in the margin documentation.

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[16] 80 Fed. Reg. 41376, 41386.

[17] Proposed Rules: PR: §__.10(a)(2); CFTC: § 23.158.

ISDA appreciates the opportunity to provide these responses. As the CFTC, the Prudential Regulators and the SEC progress in their on-going effort to refine the Proposed Rules, we would welcome the opportunity to assist in that process. Please feel free to contact me or my staff at your convenience.

Sincerely,

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Annex I

ADDRESSEES

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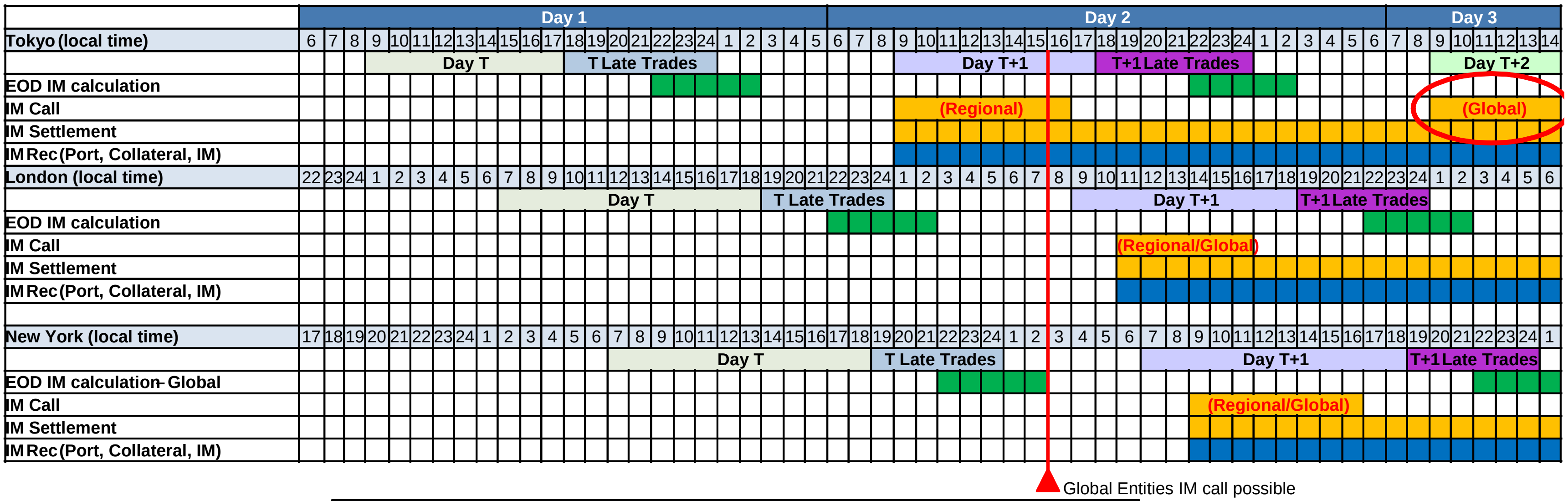
Annex II

The following illustrates a potential daily IM calculation and exchange proposal



Process

1. Calculate IM daily*
   - Late trades to be included in next days margin call
2. Call agreed amount T+1 regionally and T+2 globally (settlement occurs per industry standards)
   - If calculation amounts differ, settle lower of the two amounts
3. Perform portfolio and IM rec
4. Dispute Resolution for non -agreed margin amounts
5. Resolve dispute and settle remainder of call

* Assumes use of Regional Market Data