March 12, 2014

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Robert E. Feldman, Executive Secretary  
Attention: Comments  
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Alfred M. Pollard, General Counsel  
Attention: Comments/RIN 2590-AA45  
Federal Housing Finance Agency  
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Gary K. Van Meter, Director  
Office of Regulatory Policy  
Farm Credit Administration  
1501 Farm Credit Drive  
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Re: **Margin Requirements for Non-Centrally Cleared Swaps and Security-Based Swaps**

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ is writing with respect to the proposed margin requirements for non-centrally cleared swaps and security-

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.
based swaps (the “U.S. Margin Proposals”) published by the Prudential Regulators, the Commodity Futures Trading Commission (the “CFTC”) and the Securities and Exchange Commission (the “SEC,” and, together with the CFTC and the Prudential Regulators, the “Agencies”) pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). We understand that the Agencies are considering modifications to the U.S. Margin Proposals in order to harmonize U.S. margin requirements for non-centrally cleared swaps and security-based swaps with the final policy framework agreed by the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”) for margin requirements for non-centrally cleared derivatives (the “BCBS-IOSCO Framework”).

In this letter, we summarize and discuss, for the consideration of the Agencies in their respective U.S. Margin re-Proposals, certain key issues that are either raised by national implementation of the BCBS-IOSCO Framework or unresolved by the BCBS-IOSCO Framework. SIFMA believes that effective and consistent resolution of these issues across U.S. and international regulators is necessary to achieve the objectives of the BCBS-IOSCO Framework. This letter is intended to complement the letter submitted to the Agencies by the International Swaps and Derivatives Association (“ISDA”) on February 5, 2014.

**EXECUTIVE SUMMARY**

Implicit in the BCBS-IOSCO Framework is the recognition of the importance of inter- and intra-national consistency in margin requirements for non-centrally cleared derivatives (“OTC margin requirements”). As the Agencies consider national implementation of the BCBS-IOSCO Framework, their principal objective should be to ensure such consistency. As we explain more fully in the discussion section of this letter, to achieve that objective, and more generally to reduce systemic risk, we recommend that the Agencies take the following steps:

- **Mitigation of adverse procyclical effects.** To avoid resulting destabilizing calls for collateral during periods of extreme market stress, the Agencies should clarify that a market

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3 BCBS-IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013).

4 We have also included as Annex A to this letter a brief list of other issues that we believe the Agencies should consider in their respective U.S. Margin re-Proposals.
participant is not required, absent a direction from its prudential supervisor, to recalibrate the baseline stress scenarios and market shocks incorporated in its quantitative portfolio models based on dynamic changes in market volatilities and correlations.

- **Model approval.** To promote consistency, efficiency and transparency, the Agencies should: (a) recognize quantitative portfolio models that have been approved by home country supervisors (for firms registered in multiple jurisdictions) and consolidated supervisors (for firms subject to consolidated supervision by another regulator), in each case subject to a comparability determination; (b) permit non-registrants to use models administered by their registrant counterparties; and (c) accommodate the use of standardized models, including by non-registrants.

- **Initial margin timing requirements.** To minimize disruptive margin disputes, the Agencies should initially adopt a weekly initial margin schedule and then decrease the interval and increase the frequency of initial margin collection as portfolio reconciliation disputes are resolved more quickly and the use of standardized models becomes more widespread.

- **Consistent definitions for covered entities.** To promote international harmonization, the Agencies should (a) conform their definition of “financial entity” to the “financial counterparty” definition applicable under European rules and (b) exclude sovereign entities under a common definition of this category.

- **Structured finance/securitization SPVs.** In recognition of the appropriate alternative collateral arrangements already in place for swaps/security-based swaps with structured finance and securitization special purpose vehicles (“SPVs”), the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps with such entities.

- **Inter-affiliate swaps and security-based swaps.** To promote effective group-wide risk management, the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps between affiliates.

- **Limited “emerging market” exception.** To promote competitive parity in emerging markets while still ensuring appropriate mitigation of risk to the U.S., the Agencies should adopt an “emerging market” exception with a notional volume limitation analogous to the CFTC’s exception from transaction-level requirements for foreign branches of U.S. banks.

- **Portfolio margining.** To prevent unwarranted competitive disparities between different categories of registrant, the Agencies should accommodate portfolio margining of OTC derivatives to the fullest extent contemplated by the BCBS-IOSCO Framework.

- **Eligible collateral.** The Agencies should promote international harmonization with respect to the definitions of different categories of eligible collateral assets and provide guidance on the use of industry-developed definitions for the categories of collateral assets.

- **Phased implementation.** In recognition of the dependency of implementation efforts
on specific rules that have not yet been adopted (e.g., definitions for covered entities, covered products, and eligible collateral), OTC margin requirements should not come into effect until two years after final rules have been adopted in the U.S., the European Union and Japan.

**DISCUSSION**

A. **Initial Margin Models**

The U.S. Margin Proposals would require registrants (i.e., registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants) to collect both initial and variation margin from non-registrant financial counterparties, and to exchange initial and variation margin with each other.\(^5\) Registrants generally would be permitted to calculate the required amount of initial margin using either a standardized schedule or, with prior Agency approval, a quantitative portfolio model.\(^6\) The BCBS-IOSCO Framework also permits initial margin requirements to be calculated using a standardized schedule or, with prior supervisory approval, a quantitative portfolio model.\(^7\) Unlike the U.S. Margin Proposals, however, the BCBS-IOSCO Framework envisions a universal two-way margin exchange regime, rather than a one-way margin regime under which registrants must collect margin.

Facilitating the use of approved and consistent (if not universal) models among the broadest constituency of market participants will provide clear and significant benefits to prudential supervisors and market participants, including resource efficiency, operational efficiencies, efficient use of liquidity and reduced expense. These benefits are particularly important in the context of a margin ‘exchange’ versus margin ‘collection’ regime. In contrast, the costs to the financial system and broader economy arising from more widespread reliance on standardized schedules would be significant.\(^8\)

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\(^5\) See PR Proposed Rules _.3 and _.4; CFTC Proposed Rules 23.152 and 23.153; and SEC Proposed Rule 18a-3(c). The SEC Proposal differs from the PR Proposal and the CFTC Proposal in that the SEC has proposed (a) an alternative under which registrants would not be required to exchange initial margin with each other and (b) that major security-based swap participants would only be required to collect variation margin, not initial margin.

\(^6\) See PR Proposed Rule _.8; CFTC Proposed Rule 23.155; and SEC Proposed Rule 18a-3(d). The SEC Proposal differs from the PR Proposal and the CFTC Proposal in that the SEC has proposed that a security-based swap dealer would not be eligible to use a model for equity security-based swaps.

\(^7\) BCBS-IOSCO Framework at p. 11.

\(^8\) In this regard, we note that the quantitative impact study (“QIS”) conducted by BCBS-IOSCO in connection with its consultation or the BCBS-Framework indicated that the total amount of initial margin required under a standardized schedule would be up to 11 times higher than that observed under a models-based initial margin regime, increasing the amount of initial margin collected market-wide from approximately €700 billion to approximately €7.7 trillion. See BCBS-IOSCO, Second Consultative Document, Margin requirements for non-centrally cleared derivatives (Feb. 2013) (the “Second BCBS-IOSCO Consultation”) at p. 26-27. The QIS further estimated that reliance on standardized schedules instead of models for calculating initial margin would result in a consumption of an additional 78% of the aggregate unencumbered highly liquid assets available throughout the global financial system. Second BCBS-IOSCO Consultation at p. 36. We believe these figures under-estimate
Promoting the use of quantitative portfolio models for initial margin purposes will require the Agencies and their international counterparts to address a number of key issues, summarized below.

1. **Mitigation/Management of Procyclical Practices**

   The BCBS-IOSCO Framework is intended to limit the potential for procyclical changes in the amount of initial margin by (i) discouraging “large discrete calls for (additional) initial margin due to ‘cliff-edge’ triggers” and (ii) requiring that initial margin be set consistent with a historical period that includes a period of financial stress.\(^9\)

   While using a baseline period of stress will potentially reduce the amount by which margin calls increase in times of market stress, it will not alleviate the procyclical impact of increasing margin demands in response to sharp near-term changes in volatilities and correlations above baseline levels. Indeed, the greater the level of increased market stress, the greater the procyclical impact. It is not clear under the BCBS-IOSCO Framework whether or under what circumstances or with what frequency empirical inputs to margin models are to be updated. The level of market stress that would be appropriate or adequate in establishing the baseline scenarios and market shocks that quantitative portfolio models must incorporate is also unclear. We fear that in this respect the BCBS-IOSCO Framework may inadvertently underestimate the potential for sudden demands for collateral to increase systemic risk.

   In order to ensure market consistency and to avoid unnecessarily destabilizing calls for collateral during periods of extreme market stress, it is essential that national supervisors provide consistent and more comprehensive guidance regarding model inputs (including baseline stress scenarios and shocks) and the adjustment of model inputs. An internationally coordinated framework for addressing this issue is particularly important because, in contrast to centrally cleared derivatives, the decentralized OTC derivatives market provides no single points of contact for coordinating supervisory and private sector responses to abrupt increases in market stress.

   To accomplish these objectives, the Agencies should clarify that, while a market participant must regularly update and rerun its quantitative portfolio model for initial margin purposes so that the sensitivities of portfolio components to underlying market factors are reasonably current, a market participant is not required, absent a direction from its prudential supervisor, to recalibrate the baseline stress scenarios and market shocks incorporated in its quantitative portfolio models based on dynamic changes in market volatilities and correlations. Additionally, in order to avert destabilizing procyclical conduct effectively, the Agencies should establish a framework with their international counterparts to coordinate globally any actual levels because confusion with respect the application of the €50 million threshold in the QIS survey led many respondents to systematically over-estimate the extent to which the threshold would be available. See Letter from Kenneth Bentsen, Acting President and CEO, SIFMA to the BCBS and IOSCO Secretariats, dated Mar. 15, 2013 at p. 10-12.

determination to require recalibration of the baseline stress scenarios and market shocks incorporated in approved quantitative portfolio models so as to ensure that the impact of the recalibration would not result in unacceptably destabilizing demands for additional collateral during a period of significant market stress.

2. **Model Approval**

The BCBS-IOSCO Framework and the U.S. Margin Proposals contemplate that all models, whether internally developed or sourced from counterparties or third-party vendors, must in all cases be approved by the appropriate supervisory authority. In many cases, the appropriate approving supervisory authority will be clear, such as in the case of a prudentially supervised registrant. However, there are several circumstances in which further clarity on this topic would be helpful.

**Non-U.S. Registrants.** Consistent with the FRB’s recognition of Basel-compliant home country prudential supervisors of non-U.S. banks for capital purposes, as well as the CFTC’s and SEC’s intent to recognize comparable foreign capital standards as a basis for substituted compliance by other non-U.S. registrants, we believe that the Agencies should give recognition, for initial margin purposes, to quantitative portfolio models that have been approved by the home country regulator of a non-U.S. registrant if that regulator has implemented margin standards consistent with the BCBS-IOSCO Framework.

**U.S. Registrants Subject to Consolidated Supervision.** The CFTC Proposal recognized that, when a U.S. registrant is a subsidiary of a parent company subject to consolidated prudential supervision, deference to model approval by the registrant’s consolidated

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10 See BCBS-IOSCO Framework at p. 12; see also Note 6, supra.

11 The FRB has proposed that a registrant that is a foreign banking organization (as defined in 12 C.F.R. § 211.21(o)) or state branch or agency of a foreign bank (as defined in 12 U.S.C. §§ 3101(11) and (12)) comply with the capital requirements contained in § 225.2(r)(3) of the Board’s Regulation Y. Under § 225.2(r)(3), a foreign bank whose home country supervisor has adopted capital standards consistent with the Basel Accords is required to comply with those home country standards. We note that, as a technical matter, the “foreign banking organization” definition would not encompass a foreign bank that does not have U.S. operations. Dodd-Frank’s “prudential regulator” definition, however, designates the FRB as the Prudential Regulator for both a foreign bank with U.S. operations (under prong (A)(v) of the definition, which covers a foreign bank that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978) and a foreign bank not having any U.S. operations (under prong (A)(iii) of the definition, which covers a foreign bank which does not operate an insured branch). Moreover, the FRB is best-situated to set and enforce capital and margin requirements for a foreign bank without U.S. operations because of its long experience with foreign banking supervision generally. Accordingly, we recommend that FRB also include a foreign bank (as defined in 12 C.F.R. § 211.21(n)) as a covered swap entity subject to PR Proposed Rule 237.10(c).

supervisor can result in a more efficient use of Agency resources. In addition, because of the benefits of employing consistent risk management infrastructure across a consolidated holding company group, such deference also promotes prudent risk management practices.

For these reasons, we believe that the Agencies should give recognition, for initial margin purposes, to a quantitative portfolio model that satisfies the following conditions: (1) the model must be approved by (a) the FRB or (b) a foreign regulator that has adopted a capital regime in accordance with the Basel Accords and whose implementation of the Basel Accords yields risk-weighted assets that are comparable to the U.S. implementation of the Basel Accords, based on the findings of the Basel Standards Implementation Group (such foreign regulator, a “qualifying foreign regulator”); (2) the FRB or qualifying foreign regulator requires the registrant’s holding company to maintain uniform policies, procedures and governance requirements relating to the use of models across all the subsidiaries within its holding company group; and (3) the registrant’s use of internal models is subject to (i) prior approval by the FRB or qualifying foreign regulator of any new models or material changes to existing models, (ii) notification to the FRB or qualifying foreign regulator of any non-material changes to existing models, (iii) periodic assessment by the FRB or qualifying foreign regulator and (iv) remediation of any material weaknesses identified by the FRB or qualifying foreign regulator.

Non-Registrants. Non-Registrants will not be in a position directly to request approval of their models because they do not have their own prudential supervisors. Accordingly, if the Agencies adopt the universal two-way initial margin exchange requirement contained in the BCBS-IOSCO Framework, then it would be desirable for them to clarify that a non-registrant may use a model administered by its registrant counterparty, provided that the Agency responsible for regulating that counterparty has approved the model.

Standardized Models. As described in a recent paper published by ISDA, the broad use of standardized quantitative portfolio models result in clear benefits in efficiency, transparency and consistency. Accordingly, BCBS-IOSCO supervisors should encourage the development of, and coordinate in establishing the standards for approval of, such models. Supervisory coordination would foster consistency, and bring efficiency to the regulatory approval process for supervisors and registrants. It would also enhance transparency and level the playing field for non-registrants by making approved models available to them without reliance on their registrant counterparties. Because firms would be using a single, transparent model or library of models, the potential for disputes based on margin would be minimized. Most importantly, a standardized quantitative portfolio model that could be used for initial margin purposes would involve a coordinated, and potentially centralized, governance framework that could assist in mitigating the risk of undesirable pro-cyclical conduct. We therefore encourage the Agencies to adopt final rules that would accommodate the use of these

See CFTC Proposal at 23737.

models, *e.g.*, by establishing clear standards and a coordinated approval and oversight process for models developed by third-party vendors.

### 3. Margin Collection Timing

The PR and CFTC Margin Proposals would require that registrants call for initial margin on or before the trade date.\(^{15}\) The BCBS-IOSCO Framework, however, is less prescriptive, calling for initial margin to be collected “at the outset of a transaction,” and collected thereafter on a “routine and consistent basis” upon changes in measured potential future exposure.\(^ {16}\)

We believe the Agencies should adopt the BCBS-IOSCO Framework’s “outset of a transaction” standard in defining the point by which initial margin must be collected in the context of a newly executed transaction or the early termination, novation or material amendment of an existing transaction. A clear standard is also necessary to define the point by which market participants must call for additional initial margin due to changes in measured potential future exposure associated with a portfolio that has remained static since the most recent call for initial margin.\(^ {17}\)

We also believe, however, that the Agencies should phase in their implementation of these standards. Phased implementation of initial margin timing requirements is necessary to reduce the potential for an elevated level of margin disputes to disrupt the initial margin collection process. These disputes are often driven by portfolio reconciliation discrepancies. When market participants use proprietary models to calculate initial margin requirements, it is particularly difficult to isolate the particular swaps or security-based swaps that account for the dispute.\(^ {18}\) Thus, the interval and frequency with which market participants can effectively collect initial margin depends significantly on the time frame in which they can resolve portfolio reconciliation discrepancies and whether the parties are using a standardized model.

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\(^ {15}\) PR Proposed Rule .3(b); CFTC Proposed Rules 23.152(a)(1), 23.153(a)(1) and 23.154(a)(1).

\(^ {16}\) BCBS-IOSCO Framework at p. 14.

\(^ {17}\) As noted in part A.1. above, to avoid destabilizing calls for additional collateral during periods of market stress, no calls for additional initial margin should be required based on changes in stress scenarios and market shocks except at Agency direction (which determination should be made on a coordinated basis with their international counterparts). It would be appropriate, however, for initial margin calls to be made periodically, on a routine schedule, due to changes in a static portfolio’s market factor sensitivities.

\(^ {18}\) While the BCBS-IOSCO Framework calls for the parties, at the outset of a transaction, to agree to and record the specific method and parameters that will be used by each party to calculate initial margin, there are practical limitations on the specificity with which market participants can agree in advance on modeling methodologies and parameters, especially when proprietary, internally developed models are involved. Similar considerations led the CFTC to revise and clarify its proposed requirement that swap trading relationship documentation include a written agreement on the method, procedures, rules and inputs for determining the value of each swap. *See* Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904, 55910-13 (Sept. 11, 2012).
In light of our members’ current experiences with the portfolio reconciliation process,\(^\text{19}\) and given the possibility that standardized models may not yet be fully developed, approved or in widespread use when initial margin requirements first come into effect, we believe that a weekly initial margin schedule would be most appropriate at that time. This schedule would give sufficient time for parties to address portfolio reconciliation discrepancies associated with newly executed transactions and also establish a routine and consistent schedule for updating a portfolio’s market factor sensitivities. Such a weekly initial margin collection schedule is unlikely to give rise to significant additional systemic risk; the already-conservative parameters associated with initial margin requirements (99% confidence interval, 10-day liquidation horizon, and calibration to a period of significant financial stress), coupled with daily variation margin requirements,\(^\text{20}\) minimize the potential for significant day-to-day changes in potential future exposure to result in a systemically destabilizing build-up of uncollateralized credit exposure. In addition, the majority of market participants who will be subject to initial margin requirements during the first one-to-two years those requirements are in effect will be prudentially regulated entities that already are required to hold capital at all times against their uncollateralized potential future credit exposure.

Thus, under this approach, the collecting party would call for (1) variation margin in excess of the minimum transfer amount daily and (2) initial margin in excess of the minimum transfer amount weekly.\(^\text{21}\) As portfolio reconciliation discrepancies are resolved more quickly, and standardized models become more widespread, the Agencies could decrease the interval and increase the frequency of initial margin collection.\(^\text{22}\) We would be pleased to discuss appropriate milestones with the Agencies.

\(^{19}\) Registrants must currently establish, maintain, and follow written policies and procedures reasonably designed to resolve portfolio reconciliation discrepancies as soon as possible (but in any event within five business days), subject to an exception for a discrepancy between the lower valuation and the higher valuation of less than 10 percent of the higher valuation. CFTC Rule 23.502(a)(5).

\(^{20}\) Portfolio reconciliation discrepancies are much less likely to lead to a dispute over variation margin than over initial margin because the net present value of a new trade, which drives the variation margin call, is likely to be close to zero, and therefore unlikely to have a material effect on the variation margin amount. In contrast, even a trade that has a net present value of zero can affect the potential future exposure arising from the portfolio and therefore affect the initial margin amount. Additionally, it is easier to track a variation margin dispute to a single trade than it is to do so in the case of an initial margin dispute. This is because the variation margin amount is simply the sum of the present values of all trades in the portfolio, as opposed to a portfolio initial margin calculation that cannot be decomposed into amounts specifically attributable to individual positions.

\(^{21}\) The party posting collateral would then be required to deliver instructions for collateral to be transferred (1) the same day it receives a margin call if it receives the margin call prior to a cut-off time or (2) the following day if the margin call is received after a cut-off time. The time by which the collecting party must receive collateral should be based on the regular settlement cycle for the relevant collateral (e.g., T+2 for most major currencies), measured from the time at which the posting party was required to deliver transfer instructions.

\(^{22}\) Once the collection interval is finally reduced, the appropriate collection interval should take into account time zone differences in the context of cross-border transactions.
Finally, we emphasize that inter- and intra-national consistency in the requirements applicable to the timing of initial margin calls is essential. Effective compliance with a two-way margin exchange obligation will not be possible unless both parties to a portfolio can use the same schedule for margin collection and payment.

B. Scope of Covered Entities

The BCBS-IOSCO Framework would require that initial and variation margin be exchanged between all financial firms and all systemically important non-financial firms; sovereigns (including public sector entities), central banks, multilateral development banks, the Bank for International Settlements and non-systemic, non-financial firms would not be covered entities. However, the precise definition of these categories is to be determined by national regulation.

In this regard, the PR and CFTC Proposals would require registrants to collect initial and variation margin from all financial entities, as defined by Dodd-Frank, as well as all foreign sovereign entities. The SEC Proposal would require security-based swap dealers to collect initial and variation margin from all non-legacy counterparties that do not qualify as “commercial end users,” a term which would also be defined in part based on Dodd-Frank’s “financial entity” definition.

Because the Agencies proposed these definitions prior to finalization of the BCBS-IOSCO Framework, there are several respects in which the definitions will need to be modified to conform to that Framework:

**Sovereign Entities.** As implied by their participation in the BCBS-IOSCO Framework, we agree that the Agencies should conform their proposed definitions to the BCBS-IOSCO Framework by excluding foreign sovereigns (including public sector entities), central banks, multilateral development banks and the Bank for International Settlements from the scope of mandatory margin collection or exchange obligations. International consistency in these definitions, including the definition of public sector entities, is critical to competitive parity and comity. The importance of consistency in the inclusion/exclusion of sovereign entities is also important because local agencies, municipalities and corporations often follow the lead of their sovereign, both for swaps business and related businesses, such as debt underwriting and payment services. If the Agencies remain concerned about the uncollateralized credit exposure of their registrants to sovereign entities, we recommend that the Agencies address that credit risk concern through appropriate credit risk charges to capital.

**Financial Entity Definition.** Dodd-Frank’s financial entity definition is significantly broader than the definition of activities that will be subject to OTC margin

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23 BCBS-IOSCO Framework at p. 9.

24 Id.

25 See PR Proposed Rule _2; CFTC Proposed Rule 23.150.
requirements under the European Market Infrastructure Regulation (“EMIR”).

For instance, the definition of “financial counterparty” applicable under EMIR includes regulated investment firms, insurance companies, public investment funds, pension funds and alternative investment funds. Moreover, margin requirements under EMIR will only be applicable to (a) financial counterparties and (b) those non-financial counterparties whose derivatives activities entered into for non-hedging purposes exceed a specified threshold. Dodd-Frank’s “financial entity” definition, however, includes any entity predominantly engaged in activities that are financial in nature, regardless of whether that entity’s activities subject it to regulation or have any systemic significance.

In order to achieve substantive, and not merely facial, consistency and avoid market dislocation we believe that the Agencies should define the scope of financial entities and systemically significant non-financial entities that are subject to margin requirements for non-centrally cleared swaps and security-based swaps under Dodd-Frank in a manner consistent with EMIR. This definition would be consistent with the decision by Congress not to use the statutory “financial entity” definition in the part of Dodd-Frank that covers margin requirements, but rather to leave the Agencies with the discretion to establish such margin requirements as they determine necessary in order to help ensure the safety and soundness of registrants and in a manner that is appropriate for the risks associated with non-centrally cleared swaps and security-based swaps.

Given the more limited volume of swap/security-based swap activity by entities not falling within these definitions of financial entity and systemically significant non-financial entity, whether a registrant collects margin from such an entity should be based on the registrant’s individualized credit determination, and registrants should be free to address credit risk to such entities through other means than the collection of cash or securities, such as liens on the entity’s assets. Credit support documentation also should not be required for such non-covered entities unless they actually enter into a credit support arrangement.

**Structured Finance/Securitization SPVs.** A specific exception is also needed for non-centrally cleared swaps and security-based swaps with structured finance and securitization SPVs. Transactions with such entities are subject to additional considerations not presented in

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27 See Article 2(8) of EMIR.

28 See Article 4(1) of EMIR.

29 To the extent that Dodd Frank does not grant the Agencies the authority to impose OTC margin requirements on non-registrants, this discrepancy in treatment could also lead to competitive disparities.

30 Compare Section 2(h)(7) of the Commodity Exchange Act (“CEA”) and Section 3C(g) of the Securities Exchange Act of 1934 (the “Exchange Act”) with Section 4s(e) of the CEA and Section 15F(e) of the Exchange Act, respectively.
the context of other types of transactions. In a typical structure, an SPV issues debt that is supported by a pool of assets that serves as collateral for the issued debt and obligations to other permitted creditors, and that usually over-collateralizes those exposures. Whether to hedge interest or foreign exchange risk, or to gain market- or credit-linked exposure, the SPV might enter into one or more derivatives. However, because the SPV does not have an operating business to generate free cash flow, and generally invests all issuance proceeds in the financial assets that support its obligations, it will be very difficult for the SPV to maintain the liquidity necessary to support payments of variation margin (which are inherently unpredictable) to its derivatives counterparties, adding significant risks for both the derivatives counterparties and the securitization investors that are not present in the existing model.

For swaps or security-based swaps entered into by structured finance or securitization SPVs, the collateral arrangements may take the form most typical of securitizations generally, where there is a pledge of all or substantially all assets of the SPV to a trustee or collateral agent, and creditors are paid in accordance with a priority of payments. In some structures the swaps or security-based swaps may be secured by a combination of cash assets of the SPV and a committed credit facility. In other cases, individual credit derivatives are “defeased” by dedicated assets in a separate securities account in which the derivatives counterparty has a first priority security interest and its recourse typically is limited to those assets. These arrangements generally have proven to be commercially effective methods for the SPV to structure its derivatives exposures and for a counterparty to manage its risk to the SPV. In contrast, subjecting the SPV to margin requirements would essentially prevent it from entering into any swaps and security-based swaps at all. The imposition of an additional margin requirement in such cases would impose uneconomic costs upon the SPV and could increase the cost of capital and, as a result, the cost of financing the underlying assets.

**Inter-Affiliate Transactions.** An exception is also needed for non-centrally cleared swaps/security-based swaps between affiliates. Inter-affiliate transactions enhance hedging efficiencies and facilitate customer transactions (e.g., customers can transact with a single entity located in the customers’ jurisdiction). Additionally, global financial entities typically centralize their market risk exposures through back-to-back transactions. Centralizing this exposure allows firms to more effectively manage their risk on a group-wide basis by aggregating and netting portfolio and other risk offsets before hedging their exposure in the market. Imposing excessive margin requirements on inter-affiliate trades would frustrate these prudent risk-reducing techniques because the costs of allocating margin could outweigh the benefits gained from posting margin. Posting and collecting margin would also raise complicated cross-border operational issues and cost allocations and, in the case of segregated initial margin, would unnecessarily tie up substantial liquidity.31

There are also other mitigants to the risks of inter-affiliate transactions that are less disruptive. In particular, registrants must hold capital against credit exposures to their affiliates. In addition, financial holding companies are subject to consolidated supervision and

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31 Similar considerations to these led the CFTC to adopt an exemption to mandatory clearing for inter-affiliate swaps. See Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21749 (Apr. 11, 2013).
risk management requirements. Registrants whose transactions with affiliates raise special concerns, such as banks, are already required to collect margin from those affiliates under otherwise applicable law. Requiring such registrants to post margin to their affiliates would not be consistent with the policy objectives of those laws.

C. Emerging Market Counterparties

As noted above, the BCBS-IOSCO Framework contemplates a two-way exchange of initial and variation margin between all financial firms and all systemically important non-financial firms. Dodd-Frank, on the other hand, only authorizes the Agencies to adopt margin requirements applicable to registrants. As a result, it is not clear that the Agencies can directly require non-registrants to comply, nor directly supervise their compliance, with key aspects of the BCBS-IOSCO Framework, such as the amount of margin they collect, the segregation of initial margin, hypothecation restrictions, or the terms of dispute resolution or netting agreements. Instead, the Agencies may need to rely on registrants to obtain their non-registrant counterparties’ agreement to contractual provisions that cover these requirements.

While this approach is certainly not ideal, with certain accommodations it may be workable in the U.S. where the application of swap dealer and security-based swap dealer registration requirements will help to ensure a level playing field that prevents non-registrants from avoiding margin requirements by dealing with other non-registrants. Likewise, when U.S. registrants transact with counterparties located in jurisdictions that have adopted margin requirements consistent with the BCBS-IOSCO Framework, local margin requirements in those jurisdictions will also help to ensure a level playing field.

More serious issues will be raised, however, when U.S. registrants, whether directly or through foreign branches, seek to transact with counterparties located in emerging market jurisdictions that have failed to adopt margin requirements consistent with the BCBS-IOSCO Framework. Entities located in those jurisdictions will almost certainly refuse to agree to terms required solely as a result of Dodd-Frank regulations applicable to their U.S. registrant counterparties. This is particularly the case for entities located in jurisdictions, such as many in

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33 BCBS-IOSCO Framework at p. 9.
34 See Section 4s(e) of the CEA and Section 15F(e) of the Exchange Act (directing the Agencies to adopt margin requirements “for swap dealers and major swap participants” and for “security-based swap dealers and major security-based swap participants”).
35 We recommend that the Agencies consider the approach taken by the CFTC with respect to confirmation, swap trading relationship documentation and portfolio reconciliation requirements applicable to registrants in connection with their transactions with non-registrants, under which the CFTC did not flatly require registrants to satisfy those requirements but rather required them to adopt, maintain and follow policies and procedures reasonably designed to ensure compliance. See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904, supra Note 18.
Asia, that do not have experienced custodians or the necessary legal regimes for segregation or netting as envisioned by the BCBS-IOSCO Framework. For such an entity, compliance with Dodd-Frank would mean voluntarily agreeing to hold collateral with a custodian located outside its home jurisdiction and under documentation designed to comply with unfamiliar foreign law.

The most likely outcome under these circumstances is that emerging market counterparties will simply move their business away from U.S. registrants. The adverse impact on U.S. registrants would be amplified because so much of their swap and security-based swap activity is closely related to other commercial and investment banking relationships and activity that would be jeopardized if the required terms of swaps and security-based swaps with U.S. registrants were commercially unacceptable to their emerging market counterparties. In contrast to the potentially significant adverse impact that OTC margin requirements would have in the case of emerging market counterparties, the aggregate volume of such transactions is sufficiently low so as to pose a *de minimis* level of risk to a U.S. registrant as a whole.

These same considerations led the CFTC, in its guidance regarding the cross-border application of its Dodd-Frank swaps rules, to adopt an exception from the application of transaction-level requirements, including margin requirements, to swaps between the foreign branches of U.S. swap dealers located outside Australia, Canada, the European Union, Hong Kong, Japan and Switzerland, on the one hand, and non-U.S. counterparties that are not guaranteed or conduit affiliates, on the other hand.\footnote{Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, 45351 (July 26, 2013).} In order to ensure that this exception did not pose an unacceptable level of risk to the U.S. financial system, the CFTC conditioned the exception on the volume of such transactions not exceeding five percent of the total aggregate volume of swaps entered into by the U.S. swap dealer.\footnote{*Id.*}

We believe that the Agencies should adopt a similar “emerging market” exception to margin requirements. Under this exception, a U.S. registrant, whether transacting directly or through foreign branches, would not be required to exchange margin with counterparties located in jurisdictions that have failed to adopt margin requirements consistent with the BCBS-IOSCO Framework, provided that the total volume of transactions for which the U.S. registrant relies on this exception does not exceed five percent of the aggregate notional volume of non-centrally cleared swap/security-based swap transactions entered into by the registrant, calculated on a quarterly basis. In order to ensure international consistency, our members intend to support the adoption of a similar exception in other jurisdictions that adopt the BCBS-IOSCO Framework.

**D. Covered Products**

The BCBS-IOSCO Framework would apply margin requirements to all non-centrally cleared derivatives other than certain physically settled foreign exchange transactions. Yet, the Agencies’ mandate under Dodd-Frank extends only to non-centrally cleared swaps and

\footnote{Id.}
security-based swaps, which are defined to exclude certain types of OTC derivatives that are already regulated, such as OTC securities options. In addition, non-bank registrants under Dodd-Frank will be subject to margin requirements established separately by the CFTC and the SEC for such registrants’ swap and security-based swap activities.

While these jurisdictional limitations pose legal difficulties, especially in connection with the different insolvency and customer protection regimes applicable to different types of registrants, they are not tied to any identifiable policy objective. Indeed, the BCBS-IOSCO Framework specifically contemplates risk-based portfolio margining within broad asset class categories in a manner that is not consistent with the product divisions embedded within Dodd-Frank and related federal statutes. As a result, were U.S. registrants forced to structure their activities so as to margin non-centrally cleared swaps and security-based swaps separately from other non-centrally cleared derivatives, they would be at a significant competitive disadvantage to foreign competitors. And within the U.S., forcing non-bank registrants to margin swaps separately from security-based swaps would also put them at a significant competitive disadvantage to bank registrants. In each case, doing so would confer no corresponding policy benefit.

Accordingly, we believe the Agencies should take whatever steps are available to them to permit portfolio margining to the fullest extent consistent with the BCBS-IOSCO Framework. In particular, the Prudential Regulators should permit a bank registrant voluntarily to include non-centrally cleared non-swap/non-security-based swap derivatives within a portfolio of non-centrally cleared swaps and security-based swaps, provided that the registrant otherwise complies with all the requirements applicable to it under the rules in connection with that portfolio, including the calculation of margin amounts, recognition of netting effects and segregation of collateral. With respect to the CFTC and the SEC, SIFMA continues to support the recommendations it has previously provided regarding steps that could be taken to facilitate portfolio margining across different categories of non-centrally cleared derivatives.

E. **Eligible Collateral**

Under the PR and CFTC Proposals, eligible collateral would include cash, U.S. obligations and, for initial margin only, the senior debt obligations of Freddie Mac, Fannie Mae, the Federal Home Loan Banks, and Farmer Mac or insured obligations of a Farm Credit System Bank, subject to specified haircuts for non-cash collateral. Under the SEC Proposal, eligible collateral would include cash, obligations of the U.S. government and its agencies, and the obligations of bank holding companies.

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38 See Section 1a(47) of the CEA (definition of “swap”).

39 See Section 4s(e) of the CEA and Section 15F(e) of the Exchange Act.


41 See Letter from Kenneth Bentsen, Executive Vice President, SIFMA to Elizabeth Murphy, Secretary, the SEC, dated Feb. 22, 2013, at A2-5-A2-10.

collateral would include cash, securities and money market instruments, subject to specified or model-based haircuts for non-cash collateral, as well as qualitative liquidity standards. Like the SEC Proposal, the BCBS-IOSCO Framework contemplates a wider range of eligible collateral than the PR and CFTC Proposals, although national supervisors are responsible for developing their own lists of eligible collateral. The BCBS-IOSCO Framework also contemplates the use of either specified or model-based haircuts for non-cash collateral.

We support the more flexible approach contained in the BCBS-IOSCO Framework and the SEC Proposal. This approach would allow parties to take into account counterparty- and trade-specific considerations when determining what collateral to accept. It also would make it less likely that margin requirements could lead to market disruption as a result of undue pressure on the supply of specific types of assets acceptable as collateral.

In addition, while international harmonization with respect to the types of eligible collateral assets would be ideal, we recognize that national supervisors may wish to apply their own prudential standards in determining their own lists. Nevertheless, at a minimum, it is critical that regulators and market participants develop a set of consistent definitions for the categories of collateral assets. A set of consistent definitions would reduce operational and legal risks by reducing the likelihood that a party will inadvertently post ineligible collateral. Such definitions would also help to provide a more streamlined method by which collateral assets may be included in credit support agreements, thereby facilitating the timely implementation of margin requirements.

Similar considerations led ISDA to publish a set of collateral asset definitions in 2003. Under a mandatory margin regime, these considerations will take on even greater importance. Accordingly, in developing the list of assets that will constitute eligible collateral under their rules, we recommend that the Agencies facilitate the development of an updated set of definitions by providing guidance on the standards they would apply in deciding whether to permit registrants to use industry-developed definitions for purposes of compliance with the Agencies’ rules.

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43 SEC Proposed Rule 18a-3(c).

44 BCBS-IOSCO Framework at p. 16-17. As an illustrative list of eligible collateral, the BCBS-IOSCO Framework identifies cash, high-quality government and central bank securities, high-quality corporate bonds, high-quality covered bonds, equities included in major stock indices and gold. Id.

45 Id. at p. 17.

F. Implementation Timeline

The PR Proposal included a specific proposed effective date of 180 days after publication of final rules in the Federal Register. The CFTC and SEC Proposals did not include a specific effective or compliance date, but rather requested comments on the topic. The BCBS-IOSCO Framework, in turn, would apply universal two-way variation margin requirements to all new contracts entered into after December 1, 2015, with the implementation of initial margin requirements phased in over a four-year period beginning on that date.

We generally support the phased approach reflected in the BCBS-IOSCO Framework. We are concerned, however, that the regulatory community may be underestimating the time needed to implement universal two-way variation margin requirements. Because of the much larger number of market participants that will be covered by variation margin requirements than initial margin requirements, and the plan to implement variation margin requirements at one time, the scope of the documentation and operational changes that will need to take place is enormous. At the same time, the specific rules needed in order to make those changes effectively, such as definitions for covered entities, covered products and eligible collateral, are not yet in place. For these reasons, we believe that the two-year implementation period should commence only after final rules have been adopted in key jurisdictions, including at least the U.S., the European Union and Japan.

In addition, while it is important that the implementation timeline be one that is realistic based on the time that final rules are adopted, it is absolutely essential that margin requirements be implemented according to the same schedule in the U.S. as in other major jurisdictions. The absence of a coordinated timeline in other areas of derivatives regulatory reform, such as mandatory clearing, has led to significant market dislocation and competitive disparities. The Agencies should seek to avoid these consequences in the context of OTC margin requirements.

47 PR Proposal at 27570.
48 CFTC Proposal at 23742; SEC Proposal at 70289.
We would be pleased to provide further information or assistance at the request of
the Agencies. Please do not hesitate to contact the undersigned, or Edward J. Rosen (+1 212 225
2820) or Colin D. Lloyd (+1 212 225 2809) of Cleary Gottlieb Steen & Hamilton LLP, outside
counsel to SIFMA, if you should have any questions with regard to the foregoing.

Respectfully Submitted,

Kenneth E. Bentsen, Jr.
President and Chief Executive Officer
SIFMA

cc: Honorable Mark P. Wetjen, Acting Chairman
Honorable Bart Chilton, Commissioner
Honorable Scott D. O’Malia, Commissioner
Commodity Futures Trading Commission

Honorable Mary Jo White, Chair
Honorable Luis Aguilar, Commissioner
Honorable Daniel Gallagher, Commissioner
Honorable Michael Piwowar, Commissioner
Honorable Kara Stein, Commissioner
Securities and Exchange Commission

Honorable Janet L. Yellen, Chair
Honorable Sarah Bloom-Raskin, Governor
Honorable Jerome H. Powell, Governor
Honorable Jeremy C. Stein, Governor
Honorable Daniel K. Tarullo, Governor
Federal Reserve Board

Honorable Thomas Curry, Comptroller of the Currency
Office of the Comptroller of the Currency
Honorable Martin Gruenberg, Chairman
   Federal Deposit Insurance Corporation

Honorable Jacob J. Lew, Secretary of the Treasury and Chairman, Financial Stability Oversight Council
Honorable Mary J. Miller, Acting Deputy Secretary of the Treasury and Under Secretary for Domestic Finance
   United States Department of the Treasury

Honorable Jill Long Thompson, Chair and Chief Executive Officer
   Farm Credit Administration

Honorable Melvin L. Watt, Director
   Federal Housing Finance Agency
ANNEX A – ADDITIONAL IMPLEMENTATION ISSUES

This Annex supplements our letter by setting forth additional considerations with respect to the U.S. Margin Proposals, as taken in light of the BCBS-IOSCO Framework. To that end, we discuss these additional considerations below as they correspond to the eight “elements” set forth in the BCBS-IOSCO Framework.

**Element 1: Scope of Coverage – Instruments Subject to the Requirements**

A. Unlike the U.S. Margin Proposals, the BCBS-IOSCO Framework is silent on whether, and how, market participants would include/exclude legacy trades and trades that are out of scope but could otherwise provide risk offsets for initial margin calculation purposes.

1. The Agencies should adopt the approach proposed by the Prudential Regulators, under which legacy trades are excluded unless the registrant includes them in a netting set with new transactions.

2. The Agencies should adopt a similar approach for physically settled foreign exchange swaps and forwards that are exempted from Dodd-Frank’s margin requirements but which registrants may wish to include in a netting set with covered transactions.

**Element 2: Scope of Coverage – Scope of Applicability**

A. The BCBS-IOSCO Framework states that “[a]ll covered entities must exchange, on a bilateral basis, initial margin with a threshold not to exceed €50 million,” and that this threshold should be assessed on a consolidated group basis. 50

1. We suggest that the Agencies modify the threshold amounts included in the U.S. Margin Proposals to conform to this consolidated €50 million threshold.

2. Additionally, the Agencies should work with their international counterparts to adopt a consistent international standard for the definition of “group” that looks to the financial accounting standards applicable to an entity’s ultimate parent company.

3. The BCBS-IOSCO Framework further states that investment funds are distinct legal entities and the thresholds will generally apply at a fund-specific level even where multiple funds have the same investment advisor. 51 The Agencies should confirm the application of this principle in the case of funds organized under U.S. law or advised by investment

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50 BCBS-IOSCO Framework at p. 9.

51 Id. at n. 10.
managers registered under U.S. law where, for accounting purposes, distinct funds are not consolidated with the investment managers.

B. The BCBS-IOSCO Framework states that “[a]ll margin transfers between the parties may be subject to a de-minimis minimum transfer amount not to exceed €500,000.”

1. The Agencies should increase the $100,000 minimum transfer amount contained in the U.S. Margin Proposals to €500,000 to conform to the BCBS-IOSCO Framework, although market participants should be permitted to agree on a lower amount.

2. Additionally, the Agencies should clarify that this minimum transfer amount is to be applied separately to initial margin and variation margin.

C. The BCBS-IOSCO Framework provides that firms with less than €8 billion in annual notional trading volume shall not be subject to initial margin requirements for non-centrally cleared swaps. We believe that the Agencies should adopt this exception to conform to the BCBS-IOSCO Framework.

D. The BCBS-IOSCO Framework prescribes thresholds and other relevant financial amounts (e.g., the minimum transfer amount, the threshold for exceptions from initial margin requirements, phase-in notional amounts) in Euro. However, if jurisdictions set those amounts in their own currencies, the real value of those amounts will constantly change between jurisdictions as exchange rates fluctuate. To avoid substantial volatility in the short run, and potentially competitive imbalances in the long run, the Agencies should work with foreign regulators to decide on a single currency in which to denominate applicable thresholds.

Element 3: Baseline Minimum Amounts and Methodologies for Initial and Variation Margin

A. The BCBS-IOSCO Framework permits initial margin models to account for diversification, hedging and risk offsets within asset classes, but not across asset classes. We believe that this requirement should be interpreted to permit market participants to categorize market scenario shocks by asset class, separately apply the shocks corresponding to each asset class to the entire portfolio (without also

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52 Id. at p. 9.
53 Id.
54 Id. See also id. at p. 23-24.
55 Id. at p. 12.
categorizing individual transactions by asset class), then add the results for each asset class to generate a sum that would equal the initial margin calculation.

B. The BCBS-IOSCO Framework states that “[a]s in the case where firms use quantitative models to calculate initial margin, derivatives for which a firm faces no (ie zero) counterparty risk require no initial margin to be collected and may be excluded from the standardised initial margin calculation...”\(^{56}\) A clear definition is needed for which transactions will be considered to result in zero counterparty credit risk (which is not immediately clear given that posting variation margin inherently creates counterparty credit risk).

C. The BCBS-IOSCO Framework provides that market participants cannot cherry pick between the model and the standardized table to get more favorable terms.\(^{57}\) The Agencies should clarify that a registrant can use a standardized table for counterparties that prefer the table and internal models for counterparties that prefer models.

D. The BCBS-IOSCO Framework calls for rigorous and robust dispute resolution procedures,\(^ {58}\) which should be satisfied by the dispute resolution and valuation requirements under CFTC rules and EMIR. To the extent the Agencies intend to adopt more detailed requirements, it will be important to accommodate the use of an industry model dispute resolution mechanism, as is currently being developed by ISDA.

**Element 4: Eligible Collateral for Margin**

A. Several questions are raised by the foreign exchange risk haircut contemplated by the BCBS-IOSCO Framework.

1. The BCBS-IOSCO Framework states that this haircut is not required if collateral is “denominated in any currency in which payment obligations under the non-centrally-cleared derivatives may be made.”\(^ {59}\) We believe that existing documentation methods (such as the Standard Credit Support Annex) that use single net currency settlement for payments should satisfy this standard.

2. Additional detail about the foreign exchange haircut will be necessary in order for market participants to build a foreign exchange risk model. (For

\(^{56}\) *Id.* at p. 13.

\(^{57}\) *Id.* at p. 14.

\(^{58}\) *Id.*

\(^{59}\) *Id.* at p. 17.
example, if a risk sensitive model is applied to determine the haircut, can the underlying position be incorporated with the underlying collateral to generate the net margin call, e.g., a foreign exchange basket option denominated in several currencies?)

B. The BCBS-IOSCO Framework states that “entities covered by the requirements should ensure that the collateral collected is not overly concentrated in terms of an individual issuer, issuer type and asset type.”60 We believe that these requirements should (a) apply across a registrant’s entire pool of collateral, not individually with respect to each counterparty (particularly since collateral may be commingled across counterparties) and (b) be based on internal risk analyses subject to prudential standards and supervision, consistent with the use of internal models to establish collateral haircuts.

C. We believe that the market participants should be permitted to take into account the risks associated with collateral as part of their overall initial margin calculations, so that relationships between collateral and exposure can be taken into account by those calculations.

D. Temporary use of the collateral haircut schedule should be permitted when the type of eligible collateral to be delivered by the counterparty is unknown, such as when initial margin requirements first take effect, with a switch to a model once the collateral is identified.

Element 5: Treatment of Provided Initial Margin

A. The BCBS-IOSCO Framework does not require individual segregation at a third party, but rather that collecting parties offer individual segregation.61 Accordingly, we believe that collecting parties that are subject to direct regulation should be permitted to segregate collateral on their own books and records or to segregate collateral at a third party provided that, in the former case, the counterparty’s margin is treated as “customer property” in the collecting party’s insolvency.

B. The BCBS-IOSCO Framework explains that segregation arrangements will need to be supported by periodically updated legal opinions.62 Additional clarity is needed with respect to the legal issues that must be addressed by these opinions.

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60 Id.

61 Id. at p. 19-20. We believe that compliance with the notice requirements under Dodd-Frank’s non-centrally cleared swap/security-based segregation provisions and the CFTC and SEC rules thereunder should satisfy this obligation.

62 Id. at p. 19.
(e.g., availability of margin to the collecting party? Protection of the posting party? Under what circumstances?)

C. The BCBS-IOSCO Framework requires that initial margin be immediately available to the collecting party in the event of the posting party’s default. To achieve this objective, we believe that the Agencies’ segregation rules should provide that third-party custodial arrangements must satisfy the following requirements:

1. The custodian must either:
   
   (a) establish the custody account in the name of the collecting party and recognize the collecting party as the account holder; or
   
   (b) establish the custody account in the name of the posting party as pledgor and collecting party as pledgee.

2. The custody agreement must:
   
   (a) clearly specify the conditions under which the posting party may instruct the custodian to transfer any amount of property from the custody account without the transfer-specific instruction or consent of the collecting party;
   
   (b) restrict any such transfer to cases where the posting party certifies that (i) such a specified condition has occurred, (ii) the posting party has terminated all transactions secured by property in the custody account and (iii) the posting party is entitled to the transfer of such amount following a net settlement calculation pursuant to the terms of the governing transaction documentation;
   
   (c) require the custodian to comply with any instruction given by the collecting party exercising its rights as a secured party under the transaction documentation with the posting party to transfer or redeem property from or with respect to the custody account, or to sell or otherwise dispose of such property, without the posting party’s consent;
   
   (d) include an acknowledgement by the custodian that the property in the custody account is not subject to any right, charge, security interest, lien, or claim of any kind in favor of the bank, or any person claiming through the custodian, other than the collecting party’s claim pursuant to the custody agreement and for fees, expenses and charges lawfully accruing in connection with the

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63 Id.
custodial arrangement and, if the custody agreement or the underlying transaction agreement includes a covenant on the part of the posting party that it will deliver only cash or fully-paid for securities into the account, for any advances made by the custodian in connection with assets credited to the account; and

(e) if the account is in the posting party’s name, the custody agreement must not permit the custodian to disregard (or not to comply with) any instruction from the collecting party regarding the transfer or sale of assets in the custody account on the basis of any contrary instruction from the posting party other than a previous instruction from the customer that complies with the restrictions set out in (2)(b) above.

D. Restrictions on re-hypothecation are generally not consistent with the transfer of collateral in jurisdictions that rely on title transfer arrangements in lieu of pledges of a security interest. Given the prevalence of title transfer arrangements in non-U.S. jurisdictions (most notably, the United Kingdom), additional coordination with those jurisdictions will be necessary.

E. The BCBS-IOSCO Framework sets forth a detailed list of conditions for re-hypothecation (at Requirement 5(v)). In order to modify the U.S. Margin Proposals to conform to these conditions, the following issues should be addressed:

1. A uniform definition is necessary for “customers” whose initial margin is eligible for re-hypothecation.

2. The requirement that the initial margin collector be subject to regulation of liquidity risk should be satisfied if the collector is subject to consolidated liquidity risk requirements.

3. A uniform definition is also necessary for transactions entered into for the purpose of “hedging” derivatives positions arising from transactions with customers. This definition should include portfolio or proxy hedging.

4. “Customer property” status should be a sufficient “protection” of the customer for purposes of the BCBS-IOSCO requirement that protection be given to the customer from the risk of loss of initial margin in circumstances where either the initial margin collector or the third party becomes insolvent and where both become insolvent.

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64 Id. at p. 20-21.
Element 6: Treatment of Transactions with Affiliates

A uniform definition of “affiliate” is necessary for the purpose of an inter-affiliate exception from margin rules. We believe that this definition should be based on whether two entities are part of the same “group” for purposes of the initial margin threshold.

Element 7: Interaction of National Regimes in Cross-Border Transactions

The Agencies should permit firms that are subject to non-U.S. OTC margin requirements that are consistent with the BCBS-IOSCO Framework to comply with U.S. requirements through substituted compliance with those non-U.S. OTC margin requirements.

Element 8: Phase-In of Requirements

A. The BCBS-IOSCO Framework indicates that “all of the group’s non-centrally cleared derivatives . . . should be included” for the phase-in thresholds, but that is not consistent with the BCBS-IOSCO Framework’s general statement that “[o]nly non-centrally cleared derivatives transactions between two covered entities are governed by the requirements in this paper.” Consistent with this more general statement, the Agencies and foreign regulators should clarify that inter-affiliate transactions and transactions involving a non-covered entity will not count against the phase-in thresholds.

B. We believe that the CFTC and SEC should phase-in the implementation of capital requirements for nonbank registrants after the implementation of initial margin requirements. Applying capital and margin requirements simultaneously would put strains on the financial system. To ensure an orderly transition to the new regulatory regime, we suggest that the margin requirements apply first, followed by a two-year phase-in for nonbank registrants’ capital requirements.

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65 Id. at p. 24.

66 Id. at p. 9.