November 24, 2014

Office of the Comptroller of the Currency
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2011-0008
RIN 1557-AD43

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert deV. Frierson, Secretary
Docket No. R-1415
RIN 7100-AD74

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE21

Federal Housing Finance Agency
Constitution Center (OGC Eighth Floor)
400 7th Street, S.W.
Washington, DC 20024
Attention: Alfred M. Pollard, General Counsel
RIN 2590-AA45

Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
Attention: Barry F. Mardock, Deputy Director, Office of Regulatory Policy

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
Attention: Chris Kirkpatrick, Secretary

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Brent J. Fields, Secretary

Re: Margin and Capital Requirements for Covered Swap Entities

Ladies and Gentlemen:

The Clearing House Association L.L.C.,[1] the American Bankers Association[2] and the ABA Securities Association[3] (together, the "**Associations**") appreciate the opportunity to comment on the

[1] Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of (continued…)

notice of proposed rulemaking (the "**Proposed Rule**") by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), the Federal Housing Finance Agency and the Farm Credit Administration (collectively, the "**Prudential Regulators**"), in consultation with the Commodity Futures Trading Commission ("**CFTC**") and the Securities and Exchange Commission, entitled *Margin and Capital Requirements for Covered Swap Entities*.[4] The Proposed Rule would implement sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**")[5] by establishing initial and variation margin requirements and capital requirements for all non-cleared swaps and non-cleared security-based swaps[6] for registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants (each, a "**covered swap entity**") for which one of the Prudential Regulators is the "prudential regulator," as defined by the Commodity Exchange Act (the "**CEA**") and the Securities Exchange Act of 1934, as amended. The Proposed Rule also reflects the September 2013 Basel Committee on Banking Supervision and International Organization of Securities Commissions international framework for margin requirements on non-cleared swaps (the "**Basel-IOSCO Framework**").[7]

(…continued)

all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

2 The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans. ABA believes that government policies should recognize the industry's diversity. Laws and regulations should be tailored to correspond to a bank's charter, business model, geography and risk profile. This policymaking approach avoids the negative economic consequences of burdensome, unsuitable and inefficient bank regulation. Through a broad array of information, training, staff expertise and resources, ABA supports banks as they perform their critical role as drivers of America's economic growth and job creation.

3 ABA Securities Association is a separately chartered affiliate of the American Bankers Association, representing those holding company members of the American Bankers Association that are actively engaged in capital markets, investment banking, swap dealer and broker-dealer activities.

4 79 Fed. Reg. 57348 (Sept. 24, 2014).

5 *Codified at* 7 U.S.C. § 6s(e)(2)(A)(ii) and 15 U.S.C. § 78o-10(e)(2)(A)(ii).

6 Unless otherwise indicated, we refer to swaps and security-based swaps collectively as "swaps."

7 Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, *Margin Requirements for Non-Centrally Cleared Derivatives*, Sept. 2013, *available at* http://www.bis.org/publ/bcbs261.pdf.

The Associations strongly believe that inter-affiliate swap transactions are a prudent and critical way by which banking organizations manage their business and maintain a centralized risk management function. The Proposed Rule would unnecessarily constrain this important internal risk management tool by imposing margin requirements on inter-affiliate swap transactions, and thereby disincentivize those transactions, while providing no demonstrable benefit to the organizations themselves or the broader swap markets.

We understand that the primary goal of the margin requirements for non-cleared swaps between and among unaffiliated parties is to provide incentives to clear those transactions, thereby apparently addressing Congress's perception that non-cleared swaps expand market interconnections and thus present "greater risk."[8] However, we are aware of no determination in the Dodd-Frank Act or elsewhere that uncleared swaps occurring solely between and among affiliates pose the risks that Congress intended to address with the margin requirements, and such swaps do not increase market interconnections. Indeed, to the extent that a banking organization can manage the risks of its trades internally among affiliates, inter-affiliate swap transactions significantly decrease the need to approach third parties for risk management solutions and thereby *minimize* further financial industry interconnections. The Proposed Rule would create incentives for banks to change their inter-affiliate swaps practices, including by reducing inter-affiliate trades conducted for risk management purposes or increasing the volume of inter-affiliate trades that are cleared, both of which may increase risks to the banking organization or the markets more broadly without any countervailing benefit to the organization or financial stability. The legislative history of the relevant statutory provisions makes clear that the provisions related to swap transactions in Title VII of the Dodd-Frank Act are intended to address *third-party* risks of such transactions.[9] Accordingly, the Associations urge the Prudential Regulators to use their statutory discretion to exclude inter-affiliate swap transactions from margin requirements, consistent with the risk-based approach to implementation contemplated by the statute, and consistent with the approach that regulators in other jurisdictions, such as in the E.U. and Japan, have taken or are expected to take.

The imposition of margin requirements on inter-affiliate swap transactions not only is unnecessary as a statutory matter but raises numerous concerns, including the following:

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8 In a statement provided in connection with the CFTC's release of its proposed rule, "Margin Requirements for Uncleared Swaps for Swaps Dealers and Major Swap Participants" (Sept. 23, 2014), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister092314a.pdf at 146, Chairman Timothy G. Massad stated, "Imposing margin on uncleared swaps will level the playing field between cleared and uncleared swaps and remove any incentive not to clear swaps that can be cleared." The preamble to the Proposed Rule also notes that the swaps margin requirements in the Dodd-Frank Act are "consistent with the consensus of the G-20 leaders to clear derivatives through central counterparties where appropriate." 79 Fed. Reg. at 57351.

9 During floor debate on the proposed amendments, Senator Blanche Lincoln stated, "While most large financial entities are not eligible to use the end user clearing exemption for standardized swaps entered into with third parties, it would [be] appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between for [sic] wholly-owned affiliates of a financial entity." 156 Cong. Rec. S5921 (July 15, 2010).

- The Proposed Rule fails to take into account the fundamental differences in the risks posed by inter-affiliate swap transactions relative to swap transactions with unaffiliated third parties;
- The Proposed Rule's margin requirements, and its initial margin requirement in particular, would not only undermine the ability of banks to engage in centralized risk management with no apparent offsetting benefit to the banking organization or the swap markets, but would also appear likely to increase market interconnectivity risk by creating new incentives to replace inter-affiliate swap transactions with third-party transactions; and
- A substantial portion of inter-affiliate transactions that will be subject to the margin requirements involve banks and are thereby separately subject to quantitative limits and collateral requirements under Sections 23A and 23B of the Federal Reserve Act. Imposing a new and separate regulatory scheme on these transactions would produce redundancy and inconsistency in the manner in which such transactions are regulated and restricted.

A. Excluding Inter-Affiliate Swaps from Margin Requirements is Consistent with the Dodd-Frank Act's and the Prudential Regulators' Risk-Based Approach to Margin Requirements

Sections 731 and 764 of the Dodd-Frank Act do not themselves require that margin requirements be imposed on inter-affiliate swap transactions, nor are such requirements necessary to achieve the stated purposes of establishing margin requirements for non-cleared swap transactions. Similarly, the Basel-IOSCO Framework explicitly provides that national regulators need not impose margin requirements on inter-affiliate swap transactions. Further, excluding inter-affiliate swaps from margin requirements would be entirely consistent with the risk-based approach that the Prudential Regulators have taken in the Proposed Rule generally.

Section 731 of the Dodd-Frank Act requires the Prudential Regulators to impose "both initial and variation margin requirements on all swaps that are not cleared by a registered clearing agency."[10] The statute also requires that the margin be "appropriate for the risk associated with the non-cleared swaps held [by] a swap dealer . . . ."[11] Accordingly, the Prudential Regulators have proposed a "risk-based approach" to establishing margin requirements.[12] On the basis of that approach, the Proposed Rule would not, for example, impose on covered swap entities minimum initial margin requirements for transactions with financial end users that are not swap entities and that do not have material swaps exposure.[13] This risk-based approach to swaps with third parties clearly demonstrates the Prudential Regulators' exercise of their statutory authority to eliminate or modify margin requirements based on what is "appropriate for the [perceived] risk." A risk-based assessment of inter-affiliate swaps for purposes of applying margin requirements clearly is permissible and, as supported in this letter, similarly justifies excluding such swaps from those requirements.

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[10] The parallel provision for security-based swaps is Section 764 of the Dodd-Frank Act.

[11] 7 U.S.C. § 6s(e)(3)(A); 15 U.S.C. §78o-10(e)(3)(A); 79 Fed. Reg. at 57348.

[12] 79 Fed. Reg. at 57353.

[13] *Id.* at 57354.

The stated purpose of the margin and capital requirements set forth in Title VII of the Dodd-Frank Act is to "offset the greater risk to such entities and the financial system arising from the use of swaps that are not cleared." To offset such risk, the capital and margin requirements must help ensure the safety and soundness of the swap entity and be appropriate for the risk associated with non-cleared swaps. Furthermore, the requirements, as part of a broader framework of swaps-related provisions in the Dodd-Frank Act, are intended to: (i) reduce risk, (ii) increase transparency, (iii) promote market integrity within the financial system and (iv) address a number of weaknesses in the regulation and structure of the swaps markets that were revealed during the financial crisis of 2008 and 2009. The preamble to the Proposed Rule notes that during the financial crisis, "the opacity of swap transactions among dealers and between dealers and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty" and that imposing a margin requirement reduces this uncertainty.[14]

However, a swap transaction with an affiliate does not present the risks to a covered swap entity that are presented by a swap transaction with an unaffiliated third party, a fact which members of Congress recognized in the drafting of the swaps-related amendments in the Dodd-Frank Act.[15] Indeed, the primary purpose and effect of many inter-affiliate trades is specifically to *reduce risk* and to facilitate an efficient central risk management model, as discussed below. In addition, the parties' affiliation minimizes or eliminates many of the common risks of swap transactions that margin requirements are designed to address:

- The knowledge of credit and operations between affiliates is greater than an affiliate's knowledge of the credit and operations of any unaffiliated third party;
- Affiliates often have common treasury and risk measurement/management systems;
- The speed with which affiliates can comply with a collateral call is significantly faster than between non-affiliates;
- Affiliates' shared risk, finance, treasury and legal functions reduce the risk of disputes on margin calls;
- Affiliates typically are able to foresee stress of an affiliate far earlier than stress of an unaffiliated third party; and
- A common parent will often provide guarantees, or centralize collateralization mechanisms, which eliminates the need for, and reduces the operational risk associated with, multiple entity margin mechanics.

Because these risks are minimized, an affiliate does not experience the same degree of uncertainty in determining the point of unwind/termination of a transaction or the mechanics of the unwind in a transaction with an affiliate.

Thus, the imposition of margin requirements on inter-affiliate swap transactions is not necessary because inter-affiliate swaps do not present the risks that the Dodd-Frank Act swaps reforms were

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14 *Id.* at 57351.

15 *See* footnote 9, *supra*. If a primary purpose of the Proposed Rule is to minimize risk in connection with swap transactions, the fact that Congress recognized inter-affiliate swaps as swaps that are worthy of an exemption from mandatory clearing suggests that they do not present the "greater risk" that the statutory margin requirement was designed to address.

designed to address. The use of non-cleared swaps with an affiliate does not in the aggregate increase the risk to the covered swap entity nor would imposing margin requirements on such transactions promote market integrity within the financial system or address concerns about the "opacity" of swap transactions. The Proposed Rule does not recognize the fundamental differences between inter-affiliate trades and trades with unaffiliated third parties and provides no analysis of the relative risk of inter-affiliate trades as compared to trades with unaffiliated third parties. As noted above, a brief examination of inter-affiliate trades reveals that they are designed to reduce risk, and the risk relative to trades with unaffiliated third parties is significantly lower.

Furthermore, the Basel-IOSCO Framework does not require the imposition of margin requirements for inter-affiliate swaps.[16] Rather, noting that, in some jurisdictions, "the exchange of initial or variation margin by affiliated parties to a non-centrally cleared derivative is not customary" and that, as a result, the extension of initial margin rules to such transactions would "likely create additional liquidity demands," the Framework provides flexibility to not impose margin requirements on inter-affiliate swaps, in contrast to the mandatory nature of the margin requirement between most unaffiliated parties.[17]

Finally, to the extent that the Prudential Regulators perceive risks relating specifically to inter-affiliate swaps, margin requirements are unnecessary because there are numerous tools currently available to the Prudential Regulators to monitor those transactions and address any related concerns. For example, the Prudential Regulators have access to comprehensive data regarding swap transactions, including inter-affiliate swap transactions, as a result of various CFTC rules. In addition to being required to be subject to a centralized risk management program that is reasonably designed to monitor and manage the risks associated with inter-affiliate swaps,[18] swap transactions are also subject to comprehensive trading documentation requirements governing the terms of the trading relationship between the affiliates,[19] as well as recordkeeping[20] and reporting[21] requirements, which provide the regulators access to extensive data regarding inter-affiliate swap transactions. These requirements already are in place and could be relied on by the regulators to address concerns related to inter-affiliate swaps, rather than imposing requirements that carry additional costs, including by trapping liquidity within organizations, with no clear benefit. Furthermore, any particular concerns that the Prudential Regulators may have regarding the risks of a banking organization's inter-affiliate swap transactions may be addressed as part of the supervisory process, as recognized by the Prudential Regulators in the preamble to the Proposed Rule.[22] The terms and nature of a banking organization's inter-affiliate swap transactions are subject to the Prudential Regulators' supervisory oversight and safety and soundness authority. In addition, as described below, bank-affiliate uncleared swaps are already subject to Section 23A and Section 23B of the Federal Reserve Act, which impose quantitative limits and qualitative

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16 Basel-IOSCO Framework at 21.

17 *Id.*

18 *See* 17 C.F.R. § 50.52(b)(3) (citing 17 C.F.R. § 23.600).

19 *See* 17 C.F.R. § 50.52(b)(2) (citing 17 C.F.R. § 23.504).

20 *See* 17 C.F.R. § 45.2.

21 *See* 17 C.F.R. § 45.3.

22 79 Fed. Reg. at 57351.

requirements on all bank-affiliate transactions, including swap transactions between a bank and its affiliates.

B. The Imposition of Margin Requirements on Inter-Affiliate Transactions Unnecessarily Limits Banking Organizations' Structural and Risk Management Alternatives and Increases Risk to Banking Organizations

Consistent with legislative intent,[23] margin requirements ought not dictate or limit banking organizations' flexibility in structuring and managing their business in the absence of a compelling justification. However, the imposition of margin requirements, and initial margin requirements in particular, on inter-affiliate transactions could cause banking organizations to change their behavior to address the associated costs, which may include reducing inter-affiliate trades for risk management purposes or increasing the amount of inter-affiliate trades that are cleared. Either of these responses may increase risks to the banking organization or the markets more broadly without any countervailing benefit to the organization or financial stability.

To put these behavioral changes in perspective, it is important to understand the current role and benefits of inter-affiliate transactions. Banking organizations engage in inter-affiliate transactions for a wide range of important purposes. Inter-affiliate trades are critical to the way banking organizations conduct their business and centralize their risk management, and measures that disincentivize a banking organization's use of such trades hinder the organization's ability to advance its business, access a wider range of customers, increase the efficiency of its operations and centralize its core risk management functions. For example:

- Unlike transactions with unaffiliated third parties, inter-affiliate transactions are almost exclusively designed to hedge and properly allocate the risk within an organization. These transactions effectively permit robust enterprise-wide risk management of client transactions by allowing matching of long and short positions across affiliates' books and allowing an organization to move risks to the affiliate best able to, and specifically designated to, manage them;
- Affiliate transactions provide a banking organization with enhanced risk, balance-sheet, asset-liability and liquidity-management capabilities on a centralized basis. In fact, that inter-affiliate transactions allow a corporate group to "centrally manage" capital, liquidity and risk-allocation decisions was a significant factor behind the 2013 decision by the CFTC to exempt, subject to certain conditions, inter-affiliate swaps from mandatory clearing requirements;[24] and

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23 Senator Susan Collins stated that, in designing the swap-related amendments in the Dodd-Frank Act, Congress did not intend to "capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates," a sentiment that was seconded by Senate Banking Committee Chairman Chris Dodd. 156 Cong. Rec. S5907 (July 15, 2010).

24 CFTC, *Clearing Exemption for Swaps Between Certain Affiliated Entities* (Apr. 11, 2013), 78 Fed. Reg. at 21753, *codified at* 17 C.F.R. § 50.52. The fact that the CFTC was able to come to this conclusion indicates unambiguously that the Prudential Regulators have the authority under the Dodd-Frank Act and related implementing provisions to determine that margin requirements need not be applied to inter-affiliate transactions.

- Affiliate transactions enable customers to recognize the netting benefits of engaging in transactions with a single entity within an organization because the entity can manage the risk of those transactions centrally.

We strongly believe that the increased costs associated with the proposed margin requirements for inter-affiliate trades, particularly with respect to initial margin, will cause banks to either limit their use of inter-affiliate swaps or increase the volume of inter-affiliate swaps cleared with a third party, either of which could have a detrimental impact on the banking organization's safety and soundness or the stability of the markets. These costs include, but are not limited to, costs associated with (1) the trapping of liquidity *internally* (between affiliated parties) and *externally* (maintenance of initial margin at a third-party custodian) above and beyond any other applicable liquidity requirements, and (2) *increased* operational and counterparty risk as a result of the Proposed Rule's requirement that initial margin be segregated at an unaffiliated third-party custodian.[25] No benefit to the safety and soundness of the covered swap entity or the financial system has been articulated that would justify these significant tangible and intangible costs.

Inter-affiliate transactions are an important part of the way that banking organizations operate their businesses, manage risks and serve their customers and should therefore be encouraged. The choice, by some entities or business units, to reduce their use of inter-affiliate swaps to centrally manage risk will create and exacerbate multiple pockets of internal risk, make such pockets more difficult and costly to manage and thereby have detrimental effects on the safety and soundness of the banking organization.[26]

In addition, contrary to one of the expressed purposes of the Title VII derivatives reforms, an inter-affiliate margin requirement creates incentives that result in *increased* financial system interconnections and third-party risk, particularly with respect to central counterparty clearing houses ("**CCPs**"). The decision to undertake an inter-affiliate trade is typically based on the efficient enterprise-wide management of external risks that are generated by other transactions related to the inter-affiliate trade (such as a loan or a swap with an external counterparty, the risk of which is transmitted internally to the location or unit best able to manage that risk). An inter-affiliate margin requirement will incentivize the management of such external risks by increasing exposure to *different* external risks. Unnecessary migration of additional inter-affiliate transactions by a banking institution to central counterparties needlessly increases what may already be concentrated risks for the bank, as well as for the financial system more broadly.[27] Therefore, in the absence of a statutory mandate or evidence of a

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[25] §__.7 of the Proposed Rule. To the extent that margin consists of cash, such amounts are typically held in deposit accounts at a custodian, not as a bailment.

[26] *See* Senior Supervisors Group, Observations on Risk Management Practices during the Recent Market Turbulence (March 6, 2008) (encouraging a firm-wide approach to risk management and balance-sheet, capital and liquidity management, the hallmark of organizations that fared comparatively better during the market crisis).

[27] *See* Federal Reserve Board Governor Jerome H. Powell, speech at the "The New International Financial System: Analyzing the Cumulative Impact of Regulatory Reform", 17th Annual International Banking Conference, Chicago, Illinois, "A Financial System Perspective on Central Clearing of Derivatives" (November 6, 2014) *available at*: http://www.federalreserve.gov/newsevents/speech/powell20141106a.htm, and speech at The Clearing House 2013 Annual Meeting, New York, New York "OTC Market Infrastructure Reform:

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significant benefit to the safety and soundness of the bank or the financial system, the decision of whether to clear an inter-affiliate transaction through a CCP should be one that is driven primarily by a banking organization's internal risk management considerations.

C. Swap Transactions Between Banks and Their Affiliates Are Already Subject to the Quantitative Limits and Collateral Requirements of Sections 23A and 23B of the Federal Reserve Act

As noted in the preamble to the Proposed Rule, Sections 23A and 23B of the Federal Reserve Act continue to apply to transactions between a bank and its affiliates regardless of the requirements of the Proposed Rule,[28] and inter-affiliate transactions of covered swap entities that are banks will constitute a significant portion of the transactions affected by the margin requirements. Imposing margin requirements on transactions between banks and their affiliates under the Proposed Rule risks unnecessarily introducing inconsistent and potentially conflicting requirements. Indeed, the suggestion in the preamble that "[t]he requirements of Section 23B generally would" require the imposition on bank-affiliate swaps of the full range of margin and segregation requirements included in the Proposed Rule applicable to bank-third party swap transactions misstates the Section 23B standard. Sections 23A and 23B represent Congress's considered view of the regime to which swap transactions between a bank and its affiliates should be subject. Such transactions should be left to the legislative provisions specifically designed to address them, which is the approach taken in other regulatory contexts. For example, the national bank lending limit provisions related to derivative exposure exempt the exposure between a bank and its affiliates (as "affiliate" is defined under Section 23A and Regulation W).[29]

D. The Benefits of Extending the Margin Requirements to Non-Cleared Inter-Affiliate Swap Transactions Do Not Justify the Costs Imposed

The Proposed Rule does not explore how inter-affiliate swaps are used or measure the costs associated with imposing margin requirements, including costs that may be passed on to customers, against the efficiencies, risk reduction or related benefits of inter-affiliate swaps. The Proposed Rule thus contravenes U.S. government policy requiring an analysis and "reasoned determination" regarding the costs and benefit of a proposed rule, including the "costs of cumulative regulations," and the consideration of less burdensome alternatives.[30] We believe that a considered study by the Prudential Regulators of the incentives and disincentives created by an inter-affiliate margin requirement and the related impact on risk and the safety and soundness of banking organizations and the financial system

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Opportunities and Challenges" (Nov. 21, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/powell20131121a.htm.

28 79 Fed. Reg. at 57388.

29 12 C.F.R. § 32.1.

30 Executive Order 13563, January 18, 2011. Executive Order 13579, July 11, 2011, states that independent regulatory agencies, such as the Federal Reserve, should comply with the cost benefit analysis and regulatory burden reduction requirements of Executive Order 13563. *See also* Letter from Federal Reserve Chairman Ben Bernanke to Mr. Cass R. Sunstein, Office of Information and Regulatory Affairs, dated Nov. 8, 2011; Statement of Policy on the Development and Review of FDIC Regulations and Policies, 63 Fed. Reg. 25157 (May 7, 1998).

more generally would reveal that the costs, risk trade-offs and inefficiencies that would arise would far surpass any perceived benefits of additional intra-group margin requirements.

The Basel-IOSCO Framework cautions that the potential benefits of margin requirements must be weighed against the liquidity impact and must also be considered in the context of the "ongoing and parallel regulatory initiatives that will also have significant liquidity impacts[, including the . . .] Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and global mandates for central clearing of standardi[z]ed derivatives."[31] In the context of inter-affiliate swap transactions, the Framework specifically notes that "extending the initial margin requirements to such transactions would likely create additional liquidity demands for the firms engaging in such transactions." The Dodd-Frank Act framework also cautions that the margin requirements should be tailored to be "appropriate for the risks associated" with swaps. The Proposed Rule does not separately evaluate any of the costs associated with, or tailor any of the terms of, margin requirements on inter-affiliate swap transactions.

The benefits of imposing margin requirements on affiliate swap transactions appear negligible. The costs, by contrast, are meaningful and apparent, particularly with respect to initial margin. In addition to leading to both internal and external trapped liquidity, the incremental costs associated with initial margin include the costs of increased operational and counterparty risk as a result of the initial margin collateral segregation requirement. These increased costs in turn could result in increased costs or reduced services to customers. For example, for affiliates that are engaged in outreach to customers on behalf of the "central hub" swap dealer, increased internal margin costs in the form of increased initial margin payments or trapped initial margin amounts could result in a decrease in the number and type of trades that the affiliates are willing to undertake with customers. Most importantly, the increased costs associated with the inter-affiliate margin requirements would disincentivize organizations, including banking organizations, from centralizing their risk management function.

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If you have any questions or need further information, please contact John Court at (202) 649-4628 (email: john.court@theclearinghouse.org), Jason Shafer at (202) 663-5326 (email: jshafer@aba.com) or Cecelia Calaby at (202) 663-5325 (email: ccalaby@aba.com).

Respectfully submitted,

John Court

John Court
Managing Director and Senior Associate General Counsel

31 Basel-IOSCO Framework at 3.

The Clearing House Association L.L.C.

Jason Shafer
Vice President
American Bankers Association

Cecelia Calaby
Executive Director and General Counsel
American Bankers Association Securities Association