



DIVISION OF  
TRADING AND MARKETS

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

April 9, 2019

John J. DeBole  
Prime Solutions & Financing – Product Development  
BNP Paribas Securities Corp.  
787 7<sup>th</sup> Avenue, 8<sup>th</sup> Floor  
New York, NY 10019

Re: CDS Portfolio Margin Program

Dear Mr. DeBole:

On December 14, 2012, the Securities and Exchange Commission (“Commission”) issued an order (“Order”) granting conditional exemptive relief from compliance with certain provisions of the Securities Exchange Act of 1934 in connection with a program to commingle and portfolio margin customer positions in cleared credit default swaps (“CDS”) that include both security-based swaps and swaps in a segregated account established and maintained in accordance with Section 4d(f) of the Commodity Exchange Act (“CDS portfolio margin program”).<sup>1</sup> The exemptive relief granted in the Order is subject to certain conditions, including a requirement that a dually-registered broker-dealer and futures commission merchant (“BD/FCM”) operating pursuant to the Order must set minimum margin levels with respect to any customer transaction in the CDS portfolio margin program at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved in writing by the Commission or its staff.

BNP Paribas Securities Corp. (“BNPPSC”) has applied to the Commission for authority to offer portfolio margining for cleared CDS positions pursuant to the Order and, consequently, is seeking approval of its margin methodology (the “Methodology”) for calculating margin amounts that must be collected from customer in a CDS portfolio margin program. The Methodology must satisfy the following:

Part I – Required Margin Regime

1. BNPPSC must calculate a future credit exposure using its own proprietary methodology (“internal risk model”) subject to the minimum model standards described in Part II below.
2. BNPPSC must manage its counterparty credit risk arising from clearing CDS using the minimum risk management standards described in Part III below.

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<sup>1</sup> See Order Granting Conditional Exemption Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps, Exchange Act Release No. 68433 (Dec. 14, 2012), 77 FR 75211 (Dec. 19, 2012).



3. BNPPSC must calculate a concentration charge for portfolios using the following method.
  - a. Calculate the *net credit exposure* as (1) the future credit exposure from the internal risk model LESS (2) collected initial margin PLUS (3) uncollected variation margin. Uncollected variation margin in this context is understood as the amount that has not been collected by noon the following business day.
  - b. Calculate 1% of BNPPSC's tentative net capital from the firm's last filed FOCUS Report as the 1% threshold, unless there has been a substantial variation in the firm's capital.
  - c. For a customer whose net credit exposure is in excess of the 1% threshold, BNPPSC must either collect the net credit exposure above the 1% threshold in the form of margin from its customer or take a capital charge equal to that amount.
4. BNPPSC must maintain an internal risk report that provides a measure of the amount of leverage contained in the portfolio of each customer and make available on request by the Commission or FINRA staffs those reports and other relevant aggregate statistics.
5. BNPPSC must report to the Commission and FINRA staffs on a monthly basis within 5 business days after month end or as otherwise requested details of its top 25 customers' portfolios as measured by net credit exposure as well as the top 25 customers' portfolios as measured by gross notional amount using the attached template.

#### Part II – Minimum Internal Risk Model Standards

BNPPSC must quantify and measure the future credit exposure of a counterparty's CDS portfolio based on its own internal risk model. BNPPSC's internal risk model must meet the following minimum quantitative and qualitative requirements.

##### *Quantitative Requirements*

1. The methodology must estimate a potential future exposure over a minimum of 10-day horizon and 99% confidence level and capture all material risk factors, including but not limited to general movements in credit spread term structure, basis risk between index and single name positions, and interest rate risk.
2. The methodology must include a concentration/liquidity requirement.
3. The methodology must include a jump-to-default requirement for the sale of CDS protection equal to the largest loss of a single name exposure assuming a conservative recovery rate that may not exceed 40%.

##### *Qualitative Requirements*

1. The proprietary margining methodology must be adequately documented. The model documentation must provide a description of the model assumptions, data inputs, parameters, and methodologies employed to measure risk.
2. The proprietary margining methodology must be subject to annual model validation by a model validation group that is independent of the business function.
3. The internal risk model must be subject to at least quarterly backtesting by counterparty or account.
4. BNPPSC must request approval from the Commission or Commission staff prior to implementing any material change to its internal risk model.
5. BNPPSC must maintain the ability to compute a 90-day historical initial margin requirement considering the amount of initial margin the firm would have required during such period and future credit exposure from the internal risk model on a set of sample CDS portfolios. Each of the computations must contain a detailed breakdown of requirements by risk factor.

#### Part III – Minimum Risk Management System Standards

BNPPSC is expected to maintain risk management standards that will independently measure and manage risk arising from customers' CDS portfolios. These standards must be independent of any central counterparty margin methodology and must consider collecting additional margin from customers in accordance with BNPPSC's risk management practices. The minimum requirements for BNPPSC's risk

management system must consist of an internal credit risk model to assess the initial and ongoing credit risk of each individual counterparty. The monitoring of counterparty credit risk must include the prudent setting of exposure limits and mechanisms that would allow BNPPSC to limit or reduce the exposures to counterparties. The exposure limits must be reviewed at least quarterly based on BNPPSC's ongoing credit assessments of all of its counterparties. Positions should be valued conservatively in view of current market prices and the amount that might be realized upon liquidation. BNPPSC must also have the ability to raise margin requirements or lower exposure limits based on changes in the counterparty's credit risk profile. BNPPSC must raise margin requirements or limit counterparty exposure when positions or markets are excessively volatile. Well-defined procedures and systems must be in place for the daily collection and payment of initial and variation margin.

Pursuant to the Order and under the circumstances described above, the Division hereby approves BNPPSC's Methodology. If you have any questions, please do not hesitate to contact me at (202) 551-5525.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael M", with a stylized flourish at the end.

Michael A. Macchiaroli  
Associate Director