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November 24, 2014

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
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Washington, DC 20551

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General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Washington, DC 20024

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
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Washington, DC 20219

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

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
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RE: **Margin and Capital Requirements for Covered Swap Entities,** OCC Docket ID OCC-2011-0008 and RIN 1557-AD43; Federal Reserve Docket No. R-1415 and RIN 7100 AD74; FDIC RIN 3064-AE21; FCA RIN 3052-AC69; FHFA RIN 2590-AA45;[1] and

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, CFTC RIN 3038-AC97.[2]

Ladies and Gentlemen:

The American Bankers Association (ABA)[3] appreciates the opportunity to provide comments on the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve,

[1] 79 Fed. Reg. 57348 (Sept. 24, 2014) (the Prudential Regulators' Proposal).

[2] 79 Fed. Reg. 59898 (Oct. 3, 2014) (the CFTC Proposal).

[3] 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

Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency (collectively, Prudential Regulators) re-proposed rules to govern margin requirements for uncleared swaps and security-based swaps (collectively, swaps) by prudentially-regulated swap dealers (SDs), major swap participants (MSPs), security-based swap dealers (SBS dealers), and security-based major swap participants (major SBS participants). We also appreciate the opportunity to submit our joint comments on the Commodity Futures Trading Commission's (CFTC) re-proposed rule governing margin requirements applicable for non-prudentially regulated SDs and MSPs.[4] We appreciate the efforts of both the Prudential Regulators and the CFTC (the Agencies) in largely harmonizing their proposals (together, the Proposed Rules).

Banks and their customers use swaps to manage and mitigate the risks inherent in everyday business transactions. Margin requirements must be carefully tailored so as not to make it difficult or impossible for many banks to continue using swaps to hedge the interest rate, currency, and credit risks that arise from their loan, securities, and deposit portfolios. We have consistently supported the objective of increasing transparency and appropriate supervision of swaps and other financial products of systemic importance. However, it is critical that regulatory implementation of these objectives preserve the ability of banks to serve as engines for economic growth and job creation by providing long-term credit to businesses and offsetting the customary risk these transactions create through their own internal risk management functions.

Overview

The Dodd-Frank Act mandates that the Agencies and the SEC take a risk-based approach to imposing margin requirements on SDs, MSPs, SBS dealers and major SBS participants engaging in uncleared swaps and security-based swaps.[5] Recognizing the greater risk to the SD or MSP and the financial system arising from the use of uncleared swaps, the statute requires regulators to impose requirements to: (i) help ensure the safety and soundness of the SD or MSP; and (ii) be appropriate for the risk associated with uncleared swaps. However, as the Agencies recognized in their treatment of non-financial end users and financial end users without material swaps exposure, it does not require regulators to impose margin requirements on all uncleared swaps.

Recognizing the global nature of the uncleared swaps market and seeking to develop consistent international standards for margin requirements for uncleared swaps, in September 2013, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), in consultation with the Committee on Payment and Settlement Systems (CPSS) and the Committee on the Global Financial System (CGFS),

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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.

[4] Prudentially-regulated SDs and MSPs and CFTC-regulated SDs and MSPs (collectively, Covered Swap Entities).

[5] Section 731 also applies to the Securities and Exchange Commission (SEC), which is required to establish margin requirements for SBS dealers and major SBS participants. The SEC issued a Notice of Proposed Rulemaking on November 23, 2012 (Capital, Margin, and Segregation Requirements for SBS Dealers and Major SBS Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70214 (Nov. 23, 2012)), before the issuance of the BCBS-IOSCO Final Framework. This comment letter is intended to address the Prudential Regulators' and CFTC's re-proposals only, although we hope it is instructive to the SEC as the Commission proceeds to issue either a re-proposal or final rule.

published key objectives, elements and principles of a final margining framework.[6] Against this backdrop, the Agencies re-proposed these margin rules for implementation in the U.S.[7]

The following is a brief summary of our key recommendations:

I. Harmonization of Rules: The Agencies' and the SEC's margin rules should be completely aligned and harmonized.

II. Treatment of Non-Financial End Users: ABA largely supports the Agencies' approach to non-financial end users because it is consistent with the statute, legislative history and the end user exception from clearing.

III. Treatment of Inter-Affiliate Swaps: ABA fully endorses the joint comment letter submitted by ABA, ABA Securities Association (ABASA) and The Clearing House Association, LLC, which recommends excluding inter-affiliate swaps from margin requirements.

IV. Banks Exempt from Clearing Should Not Be Subject to Margin Requirements: Small banks that qualify for an exception from clearing should be excluded from margin requirements.

V. Threshold and Calculation of Material Swaps Exposure: Before departing from the BCBS-IOSCO Final Framework, the Agencies should undertake an analysis of liquidity and cost impacts of the proposed lower threshold. Moreover, inter-affiliate swaps and foreign exchange swaps and forwards subject to Treasury's determination should not be included in the material swaps exposure calculation. In addition, the Agencies should clarify that a Covered Swap Entity may rely on the representations of its counterparties in assessing whether it is transacting with a financial end user with material swaps exposure.

VI. Required Segregation of Initial Margin at a Third-Party, Unaffiliated Custodian: Consistent with Section 4s(l) of the Commodity Exchange Act and CFTC regulation 23.701, the non-SD counterparty to an uncleared swap transaction must be informed of its right to require segregation of its posted collateral.

VII. Treatment of Cash Margin: Clarify that cash posted as initial margin to third party custody accounts may be placed on deposit with the custodial bank.

VIII. Eligible Collateral for Variation Margin: The rules should permit parties to use the full range of collateral assets, subject to appropriate haircuts, otherwise specified in the Proposed Rules for purposes of satisfying variation margin requirements.

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[6] BCBS-IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013) (the BCBS-IOSCO Final Framework).

[7] After the publication of the BCBS-IOSCO Final Framework, the European Union published a Consultation Paper on "Draft regulatory standards on risk mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012" (Apr. 14, 2014) (the EU Proposal).

IX. Pension Plans: Pension plans should not be subject to margin requirements.

X. Cross Border: The Agencies should take steps not to constrain the global swaps market by increasing the availability of substituted compliance and providing sufficient time for comparability determinations to be made prior to the compliance date of the final rules.

XI. Treatment of Pre-Effective Date Swaps: The rules should permit legacy swaps and post-effective date swaps to be executed under a single eligible master netting agreement without subjecting legacy swaps to margin requirements.

XII. Implementation Schedule: In recognition of the time needed to make adjustments once final, uncleared margin requirements are published, the Agencies should adopt a phase-in schedule calibrated with reference to the publication of those requirements.

I. Harmonize U.S. Rules on Uncleared Swaps Margin

Section 731 of the Dodd-Frank Act requires that the Agencies and the SEC "to the ***maximum extent practicable***, establish and maintain comparable [] minimum initial and variation margin requirements, including the use of non cash collateral, for (I) swap dealers; and (II) major swap participants"[8] (emphasis added). Given this statutory directive, ABA believes that when coordinating margin rules, there should be a strong presumption that within the United States, the Agencies and the SEC maintain consistency and not diverge from each other.

The best approach would be for the Agencies and the SEC to issue jointly a comprehensive final rule to govern uncleared swaps margin. By issuing a single margin rule, these regulators would avoid creating arbitrage opportunities and provide the market with much needed clarity through the consistent treatment of uncleared swaps. A failure to completely align the U.S. rules will only lead to unnecessary confusion and an unjustified waste of resources as a result of market participants needing continually to assess which rule set governs a particular transaction. There are several key differences in the Prudential Regulators proposal and the CFTC proposal, and even the most minor differences will require market participants to dedicate resources on both an initial basis to understand what the differences are between the different regulations, and on an ongoing basis, to continue to monitor which rule applies.

By having a single comprehensive rule applicable to market participants for the treatment of margin for uncleared swaps, the Agencies and SEC would comply with the statute and provide the market with much-needed clarity.

[8] 7 U.S.C. § 4s(e)(3)(D); Dodd-Frank Act § 731.

II. We Support the Proposed Rules' Treatment of Non-Financial End Users

ABA supports the Agencies' treatment of uncleared swaps with non-financial end users.[9] The Agencies properly identified that neither statute nor public policy justify the imposition of margin requirement on non-financial end users and that a risk-based approach requires a finding that current market practice is sufficient and appropriately addresses the risk posed by swaps entered into with non-financial end users. The Proposed Rules' treatment of non-financial end users permits market participants to continue to operate pursuant to existing market practice whereby end users can negotiate collateral and margin on loans and swaps and use a broad range of collateral, such as real property, equipment, inventory, or accounts receivable.[10] Moreover, the Agencies were correct in their recognition that imposing margin requirements on end users would be inconsistent with the policy underlying the end-user clearing exception in the Dodd-Frank Act. Moreover, the Agencies correctly noted that their proposed approaches are consistent with well-established internal credit processes and standards of Covered Swap Entities, based on safety and soundness, that require covered swaps entities to use an integrated approach in evaluating the risk of their counterparties in extending credit, including in the form of a swap.

ABA commends the CFTC for taking the lead on this issue in its original 2011 proposal. However, we believe the CFTC Proposal's documentation and hypothetical initial and variation margin calculation requirements for positions held by non-financial end users that have material swaps exposure to the Covered Swap Entity are unnecessary to protect the safety and soundness of the Covered Swap Entity or financial system for the same reasons that the Agencies have recognized that they should not impose margin requirements on swaps with non-financial end users. We therefore encourage the CFTC to harmonize with the Prudential Regulators' approach in this regard.

III. Inter-Affiliate Swaps Should Not be Subject to Margin Requirements

ABA fully endorses the joint comment letter submitted by it, ABASA, and The Clearing House Association, LLC recommending that inter-affiliate swaps not be subject to margin requirements.

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[9] Both the legislative history and the text of the Dodd-Frank Act make it clear that Congress did not intend to impose margin requirements on end users. See, e.g., Letter from Senators Dodd and Lincoln to Representatives Frank and Peterson (June 30, 2010), in 156 Cong. Reg. S6192 (daily ed. July 22, 2010).

[10] Current market practice is to negotiate whether collateral or margin requirements should be included in a swap transaction with an end user. Banks underwrite all loans and swaps using the credit risk assessment standards that apply to the overall lending relationship with the customer, in which the swap exposure is almost always much smaller than the loan exposure. Loans and swaps may be collateralized by, among other things, real property, equipment, inventory, or accounts receivable. They could also be cross-collateralized with another loan or include unsecured exposures. Importantly, current market practice enables end users to use swaps to hedge their market risk. This is the essence of commercial lending – banks assess credit and market risk of the borrower, negotiate loan terms, and accept the repayment and market risk.

IV. Banks Eligible for the Clearing Exception Should Not be Subject to Margin Requirements

The Proposed Rules define all banks, regardless of size, as financial end users, thereby imposing variation margin requirements, and potentially, initial margin requirements for banks that meet the material swaps exposure threshold. Instead, we recommend that the Agencies align the Proposed Rules with the CFTC's End User Exception.[11]

We believe that the imposition of initial and variation margin requirements on small banks is inconsistent with the objectives of the CFTC's prior decision to permit small banks to use the End User Exception from clearing and with the risk-based approach the Agencies have taken in the Proposed Rules generally. On the first point, considering that one of the stated goals of these Proposed Rules is to incentivize a move to clearing,[12] the Proposed Rules potentially create a perverse outcome whereby small banks' transactions that have already been determined not necessary or appropriate for mandatory clearing are potentially incentivized to clear. On the second point, in the End User Exception, the CFTC acknowledged that small banks do not pose a systemic risk when considering "the relatively low notional volume swap books held by [SFIs][13] and the commercial customer purposes these swaps satisfy." Moreover, the CFTC recognized the minimal systemic risk that these small institutions pose in the swaps market when it estimated that the End User Exception would exempt "about 99 percent" of small financial institutions in the United States from clearing requirements.[14] Knowing the impact of the End User Exception, had the CFTC believed that the aggregate swaps activity of such institutions were systemically significant, it would not have exempted them from the clearing requirement.

In addition, ABA believes that the burdens of setting margin requirements on these small institutions eligible for the clearing exemption far outweigh the benefits. If the Proposed Rules are finalized, small banks will need to monitor their uncleared exposure to ensure they do not exceed the material swaps exposure threshold. Such monitoring will be costly for many of these small banks, which do not currently have the infrastructure to perform this monitoring.

Accordingly, in line with CFTC Commissioner Giancarlo's statement that accompanied the CFTC's Proposal, ABA requests that small entities be given the "full benefit of their clearing

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[11] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42578 (July 19, 2012) (the End User Exception). The Dodd-Frank Act directed the CFTC to consider exempting from the definition of "financial entity" small financial institutions (SFIs) with total assets of $10 billion or less, thus making them eligible for the end-user exception. Such SFIs include banks, savings associations, farm credit institutions, etc.

[12] In the CFTC Proposal at 59934, CFTC Chairman Timothy 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 Prudential Regulators' Proposal 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.

[13] The End-User Exception refers to these as "small Section 2(h)(7)(C)(ii) institutions." Small Section 2(h)(7)(C)(ii) institutions are SFIs. This provision is codified at 7 U.S.C. § 2(h)(7)(C)(ii).

[14] 77 Fed. Reg. at 42587.

exception" and that the Agencies make clear that small banks that qualify for the clearing exception will not be subject to initial margin or variation margin requirements.[15]

V. Material Swaps Exposure

In determining the appropriate scope of applicability of margin requirements for non-centrally cleared derivatives, the BCBS-IOSCO Final Framework sought to "capture all or substantially all systemic risk arising from non-centrally cleared derivatives."[16] To achieve that end, the BCBS-IOSCO Final Framework established a minimum level of €8 billion[17] in gross notional outstanding amounts before requirements for initial margin trigger for financial firms and important non-financial entities.[18] Further advancing a harmonized approach, the EU Proposal follows the BCBS-IOSCO Final Framework by setting an €8 billion threshold.

The Proposed Rules incorporate this "minimum level amount before initial margin requirements" trigger by defining the term "Material Swaps Exposure,"[19] but deviate from the €8 billion threshold amount by setting the amount at $3 billion. Relatedly, consistent with the BCBS-IOSCO Final Framework, the Agencies proposed a $65 million threshold amount below which the Covered Swap Entity need not collect or post initial margin from and to a swap entity or a financial end user with material swaps exposure.[20]

As explained in greater detail below, ABA has several concerns about the Proposed Rules' material swaps exposure calculation and the departure from the BCBS-IOSCO Final Framework calculation and believes further analysis should be completed before departing from the €8 billion amount. In addition, ABA has concerns related to certain operational issues that the Proposed Rules do not discuss.

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[15] Christopher Giancarlo's statement: "It makes no sense to provide these [small] entities with an exemption from clearing on the one hand, only to turn around and require them to bear the potentially even greater costs associated with uncleared swaps. They deserve the full benefit of their clearing exemption, which they may not get if they have to post margin." CFTC Proposal at 59936.

[16] BCBS-IOSCO Final Framework at 7.

[17] At present exchange rates, €8 billion equates to roughly $11 billion.

[18] The BCBS-IOSCO Final Framework does not use the term "swap dealer" or "major swap participant" because they are not globally defined terms.

[19] The Proposed Rules define material swaps exposure, measured for an entity's consolidated group, as the average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards (FX forwards), and foreign exchange swaps (FX swaps) with all counterparties for June, July, and August of the previous calendar year that exceeds $3 billion, where such amount is calculated only for business days. Proposed §_.2; Proposed § 23.151.

[20] This $65 million threshold is applied on a consolidated entity level, and therefore would apply across all non-cleared swaps between a Covered Swap Entity and its affiliates and the counterparty and its affiliates.

A. Material Swaps Exposure Calculation

ABA believes that the inclusion of FX swaps and forwards in the calculation of material swaps exposure is inconsistent with the Treasury's determination that these products are exempt from the definition of "swap" under the Commodity Exchange Act (CEA).[21] Pursuant to the Treasury Determination, these instruments are not subject to mandatory clearing because Treasury believed to do so "would potentially introduce operational risks and challenges to the current settlement process."[22] We do not see a compelling reason to include these instruments in the material swaps exposure calculation when they will not be subject to margin requirements. The inclusion of these FX products will only increase monitoring costs for users of FX swaps and forwards and could create an unnecessary chilling effect because market participants may hesitate to use these products to avoid exceeding the material swaps exposure threshold. In addition, ABA requests that inter-affiliate swaps be excluded from the material swaps exposure calculation. Such swaps are not outward-facing and therefore do not create the same sort of systemic risk "exposure" that this calculation seeks to capture. Furthermore, the Proposed Rules could lead to the double-counting of inter-affiliate swaps for purposes of calculating material swaps exposure.[23] For the foregoing reasons, ABA recommends that inter-affiliate swaps, FX swaps and FX forwards be excluded from the material swaps exposure calculation.

We also recommend that the Agencies do more to harmonize their approach with the BCBS-IOSCO Final Framework and their international counterparts. To begin with, consistent with the recommendation of the Securities Industry and Financial Markets Association,[24] we believe that before departing from the €8 billion threshold the Agencies should undertake an analysis of the liquidity and cost impacts of the proposed lower "material swaps exposure" threshold. The Agencies should also and conduct a related cost-benefit analysis to better inform their efforts to set this important threshold at the end of the phase-in of initial margin requirements (similar to the approach taken by the CFTC and SEC with respect to the swap dealer and SBS dealer de minimis thresholds).[25] Deferring adoption of a final volume-based exception would allow the

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[21] Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act; Final Determination, 77 Fed. Reg. 69694 (Nov. 20, 2012) (the Treasury Determination). Even though the inclusion of these instruments is consistent with the BCBS-IOSCO Final Framework, that document was issued as guidance for national regulators implementing margin requirements in their home jurisdictions in a manner consistent with the home jurisdiction's legal and regulatory framework. As directed by the U.S. Congress, Treasury made this determination after considering the unique features and pre-existing oversight of FX swaps and forwards markets. Thus, in the U.S., the adopted policy is that these FX products are not "swaps" and therefore are irrelevant for purposes of calculating a firm's material swaps exposure.

[22] Treasury Determination at 69695.

[23] In addition, the Proposed Rules are not clear about whether each leg of an inter-affiliate swap should be counted in determining a single financial end-user's material swaps exposure. Counting each leg of an inter-affiliate swap would lead to "double counting," thereby unnecessarily punishing market participants who use inter-affiliate swaps as part of their risk management practices.

[24] *See* SIFMA's Comment Letter on the Proposed Rules submitted to the Agencies on Nov. 24, 2014.

[25] The preamble discussion in the Swap Dealer definition joint final rule is instructive on this point: "The Commissions believe that a phase-in period for the de minimis threshold would facilitate the orderly implementation of Title VII by permitting market participants and the Commissions to familiarize themselves with the application of the swap dealer definition and swap dealer requirements and to consider the information that will be available about

Agencies to define that exception based on an analysis of data obtained following the effectiveness of OTC margin requirements. By analyzing these data, the Agencies could better estimate the level of initial margin requirements likely to apply to financial end users with different levels of monthly aggregate gross notional trading activity (e.g., $3 billion, $8 billion, $11 billion). These data would address the following factors not covered by a review of cleared swap margin data: (a) the level of OTC initial margin requirements, which as noted by the Agencies is likely to be higher than initial margin requirements for cleared swaps and (b) the number of Swap Entities with which a given financial end user trades, which will address the fact that a financial end user trading with multiple Swap Entities is likely to face lower initial margin requirements vis-à-vis each individual Swap Entity than if the financial end user limited its trading to a single Swap Entity.[26]

Moreover, to determine whether a financial end user is likely to face initial margin requirements in excess of the $65 million threshold, we believe the Agencies should also take into account the following other considerations relevant to the "material swaps exposure" definition:

- The amount of initial margin in excess of the $65 million threshold that financial end users whose trading volume exceeds different thresholds (*e.g.*, $3 billion, $8 billion, $11 billion) would be required to collect/post. Financial end users who face initial margin requirements only slightly in excess of $65 million are still unlikely to pose significant systemic risk;

- The aggregate liquidity impact of applying initial margin requirements to a larger number of financial end users, both during normal market conditions and during a period of significant financial stress. This analysis should account for the "leveraging" effect that the initial margin threshold has on procyclical increases in initial margin. For example, a

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the swap market, including real-time public reporting of swap data and information reported to swap data repositories. In addition, a phase-in period would afford the Commissions additional time to study the swap markets as they evolve in the new regulatory framework and allow potential swap dealers that engage in smaller amounts of activity (relative to the current size of the market) additional time to adjust their business practices, while at the same time preserving a focus on the regulation of the largest and most significant swap dealers. The Commissions also recognize that the data informing their current view of the de minimis threshold is based on the markets as they exist today, and that the markets will evolve over the coming years in light of the new regulatory framework and other developments.

We have also considered that there may be some uncertainty regarding the exact level of swap dealing activity, measured in terms of a gross notional amount of swaps, that should be regarded as de minimis. While some quantitative data regarding the usage of swaps is available, there are many aspects of the swap markets for which definitive data is not available. We have also considered comments suggesting that the de minimis thresholds should be set higher initially to provide for efficient use of regulatory resources, or that implementation of the dealer requirements should be phased. For all these reasons, the Commissions believe it is appropriate that the final rules provide for a phase-in period following the effective date during which the higher de minimis thresholds would apply." (Footnotes Omitted). 77 Fed. Reg. 30596, 30633-30634 (May 23, 2012).

[26] For example, a financial end user that has entered into $2 billion notional amount of swaps with each of five Covered Swap Entities (for an aggregate notional amount of $10 billion) would not, based on the Agencies' assumption that initial margin equals 2% of notional amount, be required to post or collect initial margin because the financial end user's initial margin amount vis-à-vis each Covered Swap Entity would only be $40 million (i.e., less than the $65 million initial margin threshold).

50% increase in a financial end user's initial margin requirements from $80 million to $120 million will, in the case of a $65 million threshold, lead to a 266% increase in the amount of initial margin collected/posted by the financial end user. As a result, subjecting a large number of financial end users whose initial margin requirements would slightly exceed $65 million to those requirements would magnify the liquidity burden associated with increased initial margin requirements during a period of financial stress, without risk mitigation benefits of corresponding significance;

- The operational costs to financial end users and Covered Swap Entities of complying with initial margin requirements;

- The number of Swap Entities that might fall below the different trading volume thresholds under consideration for incorporation into the final "material swaps exposure" definition, given that Swap Entities would be eligible for the parallel volume-based exceptions in the BCBS-IOSCO Final Framework and EU Proposal;

- The potential competitive impact of adopting a final volume-based exception from initial margin requirements that incorporates a different level (*e.g.*, $3 billion vs. €8 billion) and applies to a different scope of market participants (*i.e.*, financial end users but not Swap Entities) than the exceptions adopted in other jurisdictions; and

- The overall costs and benefits of different volume-based exceptions from initial margin requirements.

B. Representations of a Financial End User's Material Swaps Exposure Status

Covered Swap Entities are not best positioned to know the material swaps exposure of their financial end user counterparties, especially when that financial end user is doing business with multiple counterparties. That means in practice that Covered Swap Entities must rely on counterparty representations or refuse to do business with anyone not clearly above the material swaps exposure threshold, for fear of being unable to determine margin collection requirements. Therefore, ABA requests that the Agencies clarify in their final rules that Covered Swap Entities can rely on counterparty representations relating to their material swaps exposure status.

VI. Segregation of Collateral

The Proposed Rules would require all collateral posted by a Covered Swap Entity, other than collateral posted to satisfy variation margin requirements, to be held by one or more custodians that are not affiliates of the Covered Swap Entity or the counterparty (a third-party, unaffiliated custodian). In addition, the Proposed Rules would require all collateral collected by a Covered Swap Entity for purposes of satisfying initial margin requirements to be held at a third-party, unaffiliated custodian.[27]

The BCBS-IOSCO Final Framework sets forth the principle that "[i]nitial margin collected should be held in such a way as to ensure that (i) the margin collected is immediately available to

[27] The Proposed Rules also prohibit the rehypothecation of initial margin.

the collecting party in the event of the counterparty's default, and (ii) the collected margin must be subject to arrangements that protect the posting party to the extent possible under applicable law in the event that the collecting party enters bankruptcy."[28] The use of a third-party custodian is one approach to that goal, and in the view of the BCBS-IOSCO Final Framework is "considered to offer the most robust protection."[29] In line with BCBS-IOSCO Final Framework, the EU Proposal would require that a collecting party segregate initial margin from proprietary assets on the books and records of a third-party holder or custodian, or via other legally effective arrangements made by the collecting party.[30] Moreover, the collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties.

In 2013, the CFTC issued final rules to implement CEA section 4s(l).[31] Those rules are intended to govern the treatment of collateral posted to margin, guarantee, or secure uncleared swaps by counterparties.[32] In accordance with that statutory provision, those final rules apply to counterparties of SDs and MSPs and require that the non-SD counterparty to an uncleared swap transaction be informed of its right to require segregation of its collateral posted for purposes of satisfying initial margin. In the Proposed Rules, the Agencies justify their deviation from CFTC regulation 23.701 by asserting that mandatory segregation "help[s] ensure the safety and soundness of [Covered Swap Entities],"[33] "preserves financial integrity and stability,"[34] and is "appropriate for the risk" associated with uncleared swaps."[35] However, mandatory segregation goes beyond what is necessary to achieve the objectives of CEA section 4s(e).

Accordingly, ABA recommends that the Proposed Rules conform to the CFTC's current segregation rules for uncleared margin by allowing the counterparty the right to elect to segregate initial margin and imposing an obligation on the Covered Swap Entity to notify its counterparties of this right. If a party elects to segregate its initial margin, ABA would support restrictions that provide protections for the collateral of the electing party, but believes the

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[28] BCBS-IOSCO Final Framework at 19 (Key principle 5).

[29] BCBS-IOSCO Final Framework at 19 (Commentary 5(i)).

[30] EU Proposal at 42.

[31] 7 U.S.C. 4s(1), added by Section 724(c) of the Dodd-Frank Act; Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 78 Fed. Reg. 66621 (Nov. 6, 2013). In the CFTC Proposal, the CFTC proposes to amend current regulation § 23.701 to conform to the approach taken in the CFTC Proposal. *See* CFTC Proposal at 59914. We do not believe these amendments are necessary to achieve the statutory objectives of CEA section 4s(e)(3).

[32] 78 Fed. Reg. at 66621. CEA section 4s(l) does not differentiate between prudentially-regulated versus non-prudentially regulated SDs and MSPs. Therefore, we believe that the Prudential Regulators should either: i) follow this statutory directive using the CFTC rulemaking as an appropriate interpretation of what CEA section 4s(l) requires, or ii) recognize CFTC regulation 23.701 as the operative regulation for the treatment of collateral of uncleared swaps.

[33] CFTC Proposal at 59914, citing CEA section 4s(e)(3)(A)(i).

[34] CFTC Proposal at 59914, citing CEA section 4s(e)(3)(C).

[35] CFTC Proposal at 59914, citing CEA section 4s(e)(3)(A).

Agencies must be mindful of not imposing conflicting requirements on current market participants. Similarly, we believe that, consistent with the BCBS-IOSCO Final Framework, the Agencies should consider permitting limited rehypothecation on a conditional basis.[36]

VII. Clarify that Cash Posted as Initial Margin to Third Party Custody Accounts May Be Placed on Deposit with the Custodial Bank

ABA requests that the Agencies clarify that cash posted as initial margin to third party custody accounts may be placed on deposit with the custodial bank.

While securities posted to custody accounts are treated as financial assets and held off balance sheet in bankruptcy remote custodial accounts, uninvested cash is treated differently and placed on deposit with the custody bank. Like other deposits, such cash is reflected as a liability on the custodian's balance sheet and invested in suitable assets as part of the custodian bank's asset/liability management process. The holder of the custody account necessarily takes on credit risk to the custody bank. This custodial treatment of cash is common to all custody arrangements, not just the initial margin that will be subject to the segregation requirements of the proposed margin rules.

The treatment of such cash margin is unclear under the proposed rule. While placing cash on deposit with the custodial bank is standard industry practice, the proposed rule could be read to suggest that such deposits would not be permitted, under the interpretation that bank assets obtained with deposit funding constitutes prohibited "reuse" of collateral under proposed §_.7(c)(1) and proposed § 23.157(c)(1).

Prohibiting use of deposit accounts for cash margin is highly impractical. As noted above, use of such deposits is standard industry practice. Development of alternatives which could allow custody banks to hold cash off-balance sheet would require considerable time, likely be very costly for custody account holders, and could introduce new risks to the system. Requiring the development of such accounts would considerably delay the ability of market participants to comply with the proposed segregation requirements.

In addition, both the swap counterparties and the custody bank have incentives to minimize such cash deposits. Holders of custody accounts typically minimize cash placed on deposit with banks, both to limit credit risk to the bank, and to take advantage of higher yields offered by reinvesting or sweeping cash to other investment vehicles. The custody bank has an interest in minimizing cash deposits as well, due to the constraints imposed by the leverage ratio and other regulatory requirements.

We urge the Agencies to clarify that notwithstanding proposed §_.7(c)(1) and proposed § 23.157(c)(1), initial margin posted as cash is permitted to be placed on deposit with the custodial bank.

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[36] As stated in the BCBS-IOSCO Final Framework, a monitoring group will be reviewing the impact of rehypothecation. We recommend that rather than prohibit rehypothecation at the outset of the uncleared margin regime, the Agencies permit rehypothecation in line with the BCBS-Final Framework and make recommendations to BCBS and IOSCO after evaluating the effectiveness of this aspect of the Framework. *See* BCBS-IOSCO Final Framework at 21.

VIII. List of Collateral Eligible to Satisfy Variation Margin Requirements Should Be Expanded to Include the Full-Range of Collateral Assets Otherwise Specified in the Proposed Rules

The Proposed Rules unnecessarily restrict eligible collateral for variation margin to cash only.[37] This restriction is not required by statute,[38] differs from the approach taken in the EU Proposal and the BCBS-IOSCO Final Framework, and could prove onerous for certain financial end users, such as pension funds and mutual funds, which do not generally maintain levels of cash sufficient to satisfy the proposed variation margin requirements. In addition, smaller banks that operate mostly in the uncleared market because they are eligible for the clearing exemption, currently post instruments other than cash, with appropriate haircuts, to satisfy variation margin obligations. As a result of the Proposed Rules, these financial end users would likely need to rely on so-called "collateral transformation" arrangements, such as committed repo lines, to comply. These arrangements would increase the interconnectedness within the financial system, forcing financial end users to incur unnecessary additional credit exposure to banks and broker-dealers. We do not believe that this was the outcome that the Agencies were seeking.

In addition, the Proposed Rules' reliance on market practice in the cleared swaps market is not a sufficient basis for imposing this collateral limitation in the uncleared swaps market. Many of the uncleared swaps entered into by the financial end users hedge bespoke risks, meaning that those swaps are not a substitute for cleared swaps and imposing a limitation on uncleared swaps similar to those applicable to cleared swaps would not promote central clearing.

For the foregoing reasons, ABA recommends that the Agencies permit parties to use the full range of collateral assets, subject to appropriate haircuts, otherwise specified in the Proposed Rules in order to satisfy variation margin requirements.

IX. U.S. Pension Plans Should Not Be Subject to Margin Requirements

U.S. pension plans' derivatives activities can be viewed as reducing systemic risk because they are perhaps the safest of counterparties, providing a stabilizing force to the markets and prudent diversification for dealers. Moreover, current market practice in the OTC markets is that dealers rarely, if ever, require pension plans to post an independent amount (*i.e.*, initial margin) to transact in the OTC markets.[39]

Therefore, following a risk-based approach, U.S. pension plans should be treated the same as non-financial end users for purposes of this rule because they are highly regulated, highly

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[37] The Proposed Rules restrict eligible collateral to cash denominated in either USD or in the currency in which payment obligations under the swap are required to be settled.

[38] Section 731 of the Dodd-Frank Act requires that the regulators "shall permit the use of non-cash collateral" so long as doing so is consistent with preserving the financial integrity of the swaps market and the stability of the U.S. financial system. 7 U.S.C. 4s(e)(3)(C); Dodd-Frank Act § 731.

[39] While not determinative, it is noteworthy that dealers, who conduct the extensive credit analysis needed to protect themselves against a client default, have concluded that pension funds are low-risk counterparties that do not pose material default risk.

creditworthy, low leveraged and prudently managed counterparties whose swaps are used primarily for hedging and, as such, pose little risk to their counterparties (*i.e.*, Covered Swap Entities) or the broader financial system.[40]

X. Further Consideration of the Agencies' Cross Border Approach is Merited

Swaps markets are global in nature. Without harmonized regulatory approaches, these markets are particularly subject to fragmentation and migration away from regulated entities. Throughout the swaps rulemaking process, we have encouraged the Agencies to be mindful of the competitive and market implications of their cross-border regulatory initiatives on the various business structures through which U.S. banks conduct business overseas. The efforts of the Agencies to harmonize the substance and timing of margin requirements with key non-U.S. regulators via the Basel-IOSCO process is a significant step to reduce competitive disparities and conflicting requirements and to ensure an orderly implementation of final rules. However, the Proposed Rules continue to take an unnecessarily broad extraterritorial scope as well as diverge from the Basel-IOSCO Final Framework in ways that promote competitive discrepancies and conflicting obligations. In particular, the following requires further consideration:

- The Agencies should permit market participants to rely on substituted compliance based on comparable rule sets to the greatest possible degree across the markets in and structures through which they operate;

- The Agencies should incorporate a de minimis exception for swap activities conducted in jurisdictions for which substituted compliance is not available, similar to the exception promulgated by the CFTC in its Cross-Border Guidance; and

- To decrease the likelihood of market fragmentation and to help streamline implementation efforts, the Agencies should provide sufficient time for foreign jurisdictions to establish margin requirements prior to enforcing final margin rules. This will enable the Agencies to issue comparability determinations on other jurisdictions' margin rules.

Cross-border considerations continue to raise complicated issues and it is important that the Agencies seek to address the risks in the swaps market without unduly constraining the global nature of those markets. We look forward to a collaborative and deliberate dialogue on cross-border issues with the Agencies as they continue to continue to pursue a global regulatory framework that meets policy objectives without deterring cross-border activity.

[40] Fiduciaries of ERISA governed plans are subject to ERISA's various stringent fiduciary duties (including duty to act prudently in making investment decisions), which will subject the fiduciary deciding to enter into the swap on behalf of the plan to a very high standard of care. While U.S. governmental plans are not subject to ERISA's fiduciary duties, they will have their own local law governing the plan investments but generally these laws will also impose a fiduciary duty on investment of swaps. Thus, given existing legal regimes in place, these plans should be free to negotiate their own collateral requirements for swap trading in accordance with fiduciary duties.

XI. Permit Legacy Swaps and Post-Effective Date Swaps to Be Executed Under a Single Eligible Master Netting Agreement Without Subjecting Legacy Swaps to These Margin Rules

ABA generally supports the Agencies' approach to the treatment of uncleared swaps entered into before the effective date of these rules (legacy swaps), but believes that the Proposed Rules unnecessarily introduce risk into the financial system by requiring that the Covered Swap Entity execute a new eligible master netting agreement (EMNA) if it wishes to exclude legacy swaps from the final margin rules. ABA believes that the Agencies should encourage market participants to use close-out netting to the maximum extent possible, in order to mitigate credit risk and achieve other benefits[41] that can only be realized when swaps are executed under a single EMNA. If a Covered Swap Entity is required to execute a new EMNA in order to ensure its legacy swaps are not subject to margin requirements, it will lose the benefit of close-out netting its pre- and post-effective date positions, exposing it to even more risk and diminishing the safety and soundness of the Covered Swap Entity and the financial system.

XII. Implementation Schedule for Uncleared Swaps Margin Requirements

The Proposed Rules would apply variation margin requirements to all Swap Entities and financial end users beginning December 1, 2015, and would phase-in the application of initial margin requirements annually from December 1, 2015 until December 1, 2019, depending on the average daily aggregate notional amount of all uncleared swaps, FX swaps and FX forwards of each of the parties (together with its affiliates) for the preceding June, July and August.

These rules represent a major change to industry practice and a more flexible approach would allow market participants to implement these requirements without causing unnecessary market disruption. These rules will require the development of new systems, models, infrastructure, and operations, in addition to a major shift in the business model of many affected participants. For example, implementing the $65 million initial margin threshold across affiliates will require new technology solutions as affiliate systems will need to interact with each other in a way they currently do not.

In addition, given the significant documentation and operational changes needed to accommodate a global variation margin regime, the Agencies should adopt a phase-in for variation margin. Forcing these market participants to come into compliance too soon could increase risk and the potential for errors by fostering funding, documentation and operational practices that have not yet received appropriate review or testing.

The initial December 1, 2015 compliance date proposed by the Agencies is consistent with the initial compliance date set forth in the BCBS-IOSCO Final Framework. However, that framework was published over 14 months ago, implying a transition period of longer than 2 years. Finalization of the Proposed Rules, in contrast, is not likely to occur until the first half of 2015, implying a 6-9 month transition period.

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[41] ISDA Research Notes: The Importance of Close-Out Netting, by David Mengle, ISDA Head of Research (Nov. 1, 2010), available at http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf

Accordingly, consistent with SIFMA's recommendation,[42] the Agencies should:

- Phase-in variation margin requirements based on decreasing notional amount thresholds over a two-year period commencing upon the later of (i) publication of final OTC margin rules in the United States, European Union and Japan or (ii) publication of the Agencies' comparability determinations with respect to the European Union and Japan (such later date, the Publication Date); and

- Commence the proposed initial margin phase-in schedule two years after the Publication Date.

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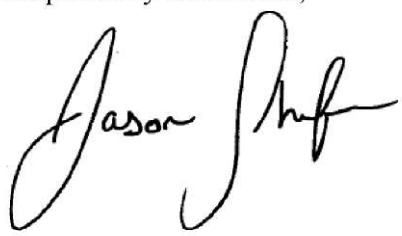
We thank the Agencies for the opportunity to comment on these Proposed Rules. We appreciate the efforts of the Agencies to coordinate their rules and ABA looks forward to continuing the work with the Agencies to finalize and implement these rules. Should you have any questions, we are available to discuss any of these issues in more detail.

Please contact Jason Shafer a 202-663-5326 or jshafer@aba.com if you have any questions.

Respectfully Submitted,



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[42] *See* SIFMA's Comment Letter on the Proposed Rules submitted to the Agencies on Nov. 24, 2014.