ISDA® Safe, Efficient Markets

January 16, 2015

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th St, SW, Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219

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

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

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

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

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

RESPONSES TO QUESTIONS AT MEETING ON DECEMBER 12, 2014 RE MARGIN REQUIREMENTS FOR UNCLEARED SWAPS

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") appreciates the opportunity to provide responses to the questions raised by the representatives of the Prudential Regulators[2]

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

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

(the "**PRs**") at the meeting with representatives of ISDA on December 12, 2014 to discuss the proposed rulemaking (**"PR Margin Proposal"**)[3] for margin for non-cleared swaps.

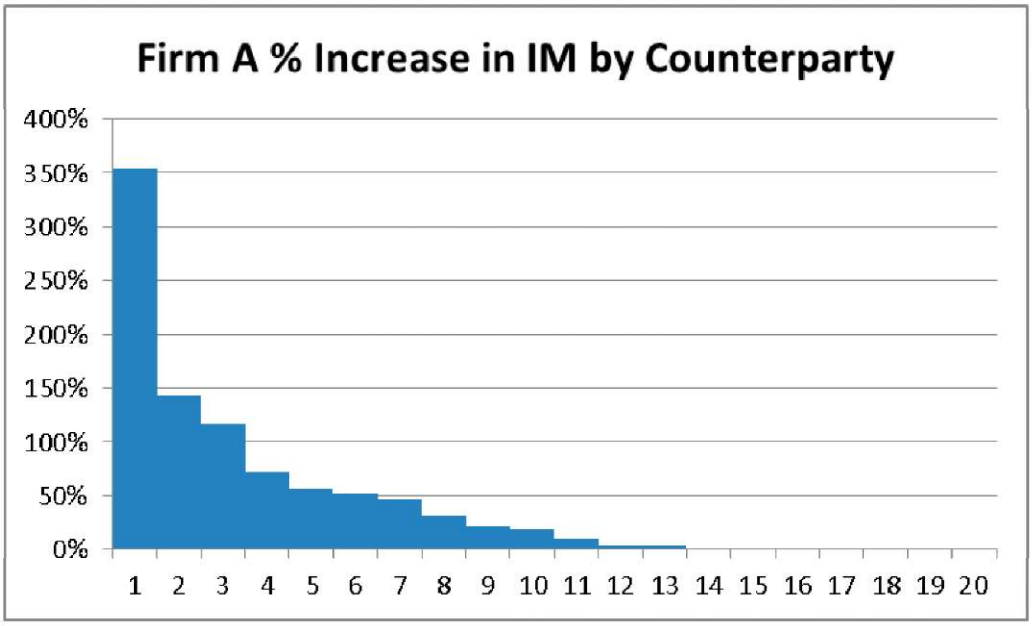
The questions and our responses are set out below.

QUESTION #1: What is the impact on initial margin ("IM") levels of using risk factors rather than classifying swaps by asset classes?

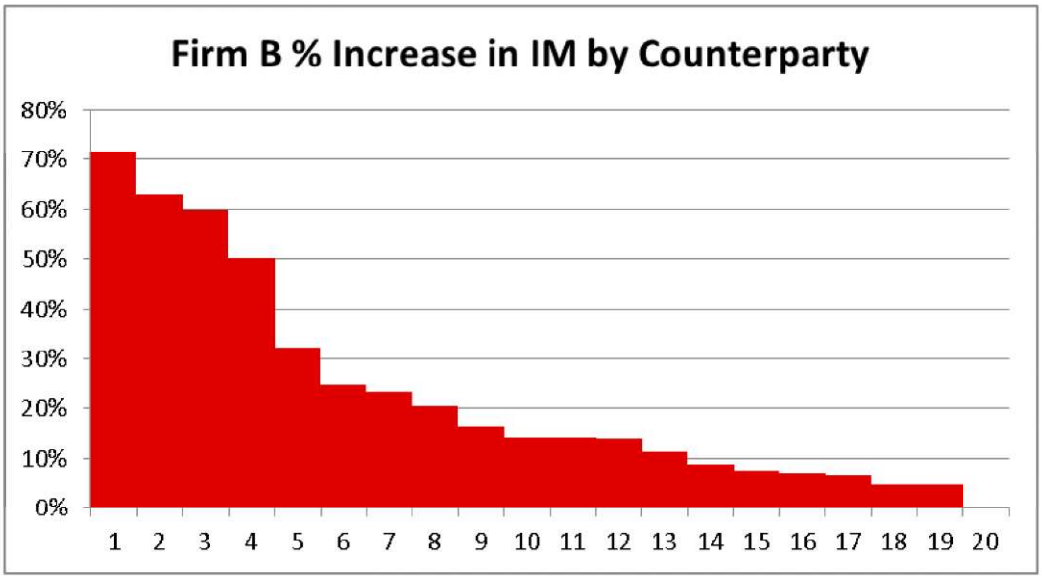
In response to Question #1, the ISDA SIMM Risk Classification & Methodology Working Group analyzed the impact of bucketing trades by asset class versus bucketing by risk factor when calculating IM.

To substantiate the impact, two ISDA member firms calculated IM under both approaches (bucketing by asset class versus bucketing by risk factor) for their largest 20 counterparties (by IM) and recorded the percentage difference of the IM requirements. Note that the sorting of trades by asset class was necessarily somewhat approximate, since in practice assigning trades to asset class silos is difficult and rather subjective.

The graphs below show those percentage differences (by-asset class minus by-risk) for the two firms.



[3] Prudential Regulators, *Margin and Capital Requirements for Covered Swap Entities*, 79 FR 57348.



For many of these major counterparties, the IM requirement when the silos are defined by asset class is more than 50% higher than the IM requirement using risk factors. And for one counterparty, the increase is more than 350%. (For reference, the underlying numbers are also shown in a table below.)

Some counterparty portfolios are more sensitive to this methodology question than others. This is not surprising – it simply reflects the composition of those portfolios. For example, a firm's trades with a certain counterparty may be spread across several currencies and several asset classes. If the trades are split by asset class then the FX risk on trades in different silos will not be allowed to net, causing a substantial increase in the margin requirement. By contrast, the firm's trades with another counterparty may be based overwhelmingly in one currency, so that the lack of netting of FX risk between asset class silos is not significant on that portfolio.

We therefore request that the regulators allow IM to be calculated using risk factors rather than asset classes. To recap some of the reasons for this:

- As demonstrated by the data presented here, asset class bucketing would result in serious over-margining for certain types of counterparty, skewing the playing field against those counterparties.
- Assigning trades to buckets by asset class in a way that is consistent across all firms calculating IM presents enormous practical difficulties. There are already numerous examples of hybrid trade types that do not fit into any of the asset class silos, and product innovation continually makes this problem worse. Any discrepancies between the ways in which different firms performed this bucketing would lead to margin disputes.
- In order to account for the FX risk of variation margin ("**VM**") when calculating IM, the best approach is to add the FX risk of the VM to the FX risk of the portfolio. It is unclear how to do this if the portfolio is split by asset class – in which asset class should the VM be put?
- Bucketing risks is the theoretically correct thing to do, whereas bucketing trades is not. When closing out trades against a defaulted counterparty, the EUR/USD FX risk on the

equity derivatives in that portfolio clearly nets against the EUR/USD risk on the credit derivatives.

- The standardized Sensitivity Based Approach in the Fundamental Review of the Trading Book ("**FRTB**") (on which SIMM is based) splits transactions by risk type and not by asset class. It makes sense for SIMM to follow the paradigm used by the FRTB.

The table below shows the percentage differences between IM split by asset class and IM split by risk type, ordered by IM requirement.

Firm A		Firm B	
Counterparty A1	0%	Counterparty B1	11%
Counterparty A2	52%	Counterparty B2	0%
Counterparty A3	57%	Counterparty B3	23%
Counterparty A4	32%	Counterparty B4	9%
Counterparty A5	4%	Counterparty B5	8%
Counterparty A6	18%	Counterparty B6	5%
Counterparty A7	2%	Counterparty B7	6%
Counterparty A8	2%	Counterparty B8	14%
Counterparty A9	21%	Counterparty B9	32%
Counterparty A10	9%	Counterparty B10	14%
Counterparty A11	0%	Counterparty B11	14%
Counterparty A12	0%	Counterparty B12	63%
Counterparty A13	143%	Counterparty B13	7%
Counterparty A14	0%	Counterparty B14	5%
Counterparty A15	47%	Counterparty B15	50%
Counterparty A16	72%	Counterparty B16	72%
Counterparty A17	0%	Counterparty B17	20%
Counterparty A18	354%	Counterparty B18	16%
Counterparty A19	117%	Counterparty B19	60%
Counterparty A20	3%	Counterparty B20	25%

QUESTION # 2: What is the impact of requiring IM for inter-affiliate swaps?

In response to Question #2, members analyzed the gross notional amounts of uncleared inter-affiliate derivatives where 1) at least one of the parties is a depository institution and 2) neither party is a depository institution.

To substantiate the impact of having to post IM to inter-affiliate counterparties, two ISDA member firms calculated what the total IM requirement would be if they had to a) post IM to only external counterparties and b) post IM to both internal and external counterparties. The analysis showed that if all affiliates are mandated to post IM to each other, they would expect the amount of IM to increase by 100% (i.e. double) relative to if they only have to post IM externally. Of the total increase in IM required for affiliates, the member firms estimated that the depository institutions would collect 13-37% of the total IM that their affiliates would have to post to each other.

In addition, ISDA member firms were asked to provide the total gross notional amounts of uncleared inter-affiliate derivatives where 1) at least one of the parties is a depository institution (regulated by the FDIC) and 2) neither party is a depository institution (regulated by the FDIC). The inter-affiliate transactions involving depository institutions were measured using total gross notional amounts.

Firm	% Gross notional of uncleared inter-affiliate derivatives where at least one of the parties is a depository institution (regulated by the FDIC)	% Gross notional of uncleared inter-affiliate derivatives where neither party is a depository institution (regulatedby the FDIC)
Firm 1	60.66%	39.35%
Firm 2	16.24%	83.76%
Firm 3	99.43%	0.57%
Firm 4	14.01%	85.99%
Firm 5	91.71%	8.29%
Total [4]	**37.94%**	**62.06%**

QUESTION #3: What is the effect of the prohibition on "walkaway clauses" under the capital rules?

At the December 12 meeting, the topic of "walkaway clauses" in master netting agreements was initially raised by ISDA because the proposed definition in the PR Margin Proposal of walkaway clause included any provision that "suspends or conditions" payment to a defaulter. (Generally, a "walkaway clause" is a clause that states that a non-defaulting party is excused from making payments, or permitted to make reduced payments, to a defaulter even if the defaulter is in-the-money.)

However, after the meeting, the Fed and the OCC issued a new capital rule[5] that defines walkaway clause. In this capital rule, the new definition of walkaway clause does not include a provision that "suspends or conditions" payments to a defaulter. In the preamble to the capital rule, the Fed and the OCC stated that they intend to use the same definition in the margin rules for uncleared swaps.[6] We assume that the PR's final margin rule will follow this stated intent. As a result, ISDA no longer needs to raise this issue with the PRs.

QUESTION #4: What is the volume of swaps with counterparties in "non-netting jurisdictions" (i.e., jurisdictions in which netting of swaps is not enforceable in insolvency)?

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[4] Total figures were obtained by calculating the weighted sum of notional amounts across participants for each category as a percentage of the total gross notional.

[5] Federal Reserve, Office of the Comptroller of the Currency "Regulatory Capital Rules, Liquidity Coverage Ratio: Interim Final Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions", 79 FR 78287 (Dec. 20, 2014).

[6] 79 FR 78287, 78291.

ISDA member firms were asked to provide the total gross notional amount for their uncleared derivatives for all jurisdictions (netting and non-netting).[7] For all non-netting jurisdictions, they were asked to provide the name of the jurisdiction and the total gross notional amount of uncleared derivatives with counterparties in that jurisdiction. A complete list of the provided jurisdictions and total gross notional percentages can be found in Appendix A.

Below is a summary, by institution, of the % of total outstanding notional with non-netting jurisdictions and the maximum gross notional % traded with counterparties in a single non-netting jurisdiction. As we observed, only a small percentage of the total outstanding gross notional for uncleared derivatives is concentrated in non-netting jurisdictions, however, there are instances where this concentration may exceed 5% for a given covered swap entity.[8]

	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
% of total outstanding notional with non-netting jurisdictions	0.2711%	0.4091%	0.5326%	0.5117%	0.3042%	0.4099%	5.4160%	2.6963%	0.5247%
Maximum gross notional % to a single non-netting jurisdiction	0.1346%	0.1311%	0.4199%	0.2619%	0.1056%	0.2011%	2.2356%	1.7083%	0.1893%

There are only two non-netting jurisdictions where the total notional amount exceeds 0.1%[9] of all uncleared derivatives transactions, shown below.

Jurisdiction	Total
CHINA	0.1893%
UNITED ARAB EMIRATES	0.1059%

Below is the count of individual firm exposures to non-netting jurisdictions grouped by percentage of total outstanding notional by (a) less than .05%; (b) between .05% & .1%; and (c) greater than .1%.

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7 Non-netting jurisdictions are assumed to be those other than the "clean netting jurisdictions". The list of clean netting jurisdictions may also be found at http://www.isda.org/docproj/stat_of_net_opin.html

8 We reiterate our request that covered swap entities not be required to post margin (initial margin or variation margin) to counterparties in jurisdictions lacking enforceable netting. As noted in our original response letter to the US Prudential Regulators, without enforceable netting, there is the risk that the administrator of an insolvent counterparty will "cherry-pick" from posted collateral to be returned in the event of insolvency, which will result in an increase in the risk in posting collateral.

9 Total figures were obtained by adding the sum of notional amounts across participants for each jurisdiction as a percentage of the total gross notional.

Count of exposures:	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
Less than .05%	27	34	2	16	45	16	32	8	75
Between .05% & .1%	1	2	0	2	1	2	5	1	1
Greater than .1%	1	1	2	1	1	1	5	2	2

QUESTION #5: What is the appropriate timing for IM calls and collection?

As discussed at the meeting and in our prior letter to the PRs[10], we are concerned that the PR Margin Proposal does not allow enough time for calls and collection of IM. We emphasize the importance of allowing sufficient time for both call and collection because these are two separate tasks. The call requires the calculation and reconciliation of IM. Collection requires exchange of information and delivery of the collateral.

In order to preserve the ability of firms that book trades in different timezones to continue to trade with each other, allowance should be made so that a trade can be booked before the Close of Business ("**COB**") for one firm, but miss the COB for the counterpart. Such trade would be recognised as booked the following day by the counterparty and be processed for margin purposes on that day. (See Appendix B.) Many firms use multiple COBs (for example by remote booking) in the same legal entity and as the IM calculation is determined at the legal entity level, it cannot begin until the COB in the last regional timezone of that entity.

Additionally, margin calls may be issued by one firm after the COB for the counterparty. The counterparty will receive the call on the following day and process accordingly.

Finally, the time required to settle IM collateral will vary according to the normal settlement cycle for that type of collateral. As the rules allow for collateral types with settlement cycles up to T+3, the required time for the margin call to complete should not prohibit those collateral types.

To resolve all of these issues it is proposed that swap dealers should be allowed up to T+5 to collect margin.

* * *

[10] ISDA Letter to the PRs, dated Nov. 24, 2014.

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

Sincerely,

Eric Litvack

Chairman

ISDA

cc: Commodity Futures Trading Commission

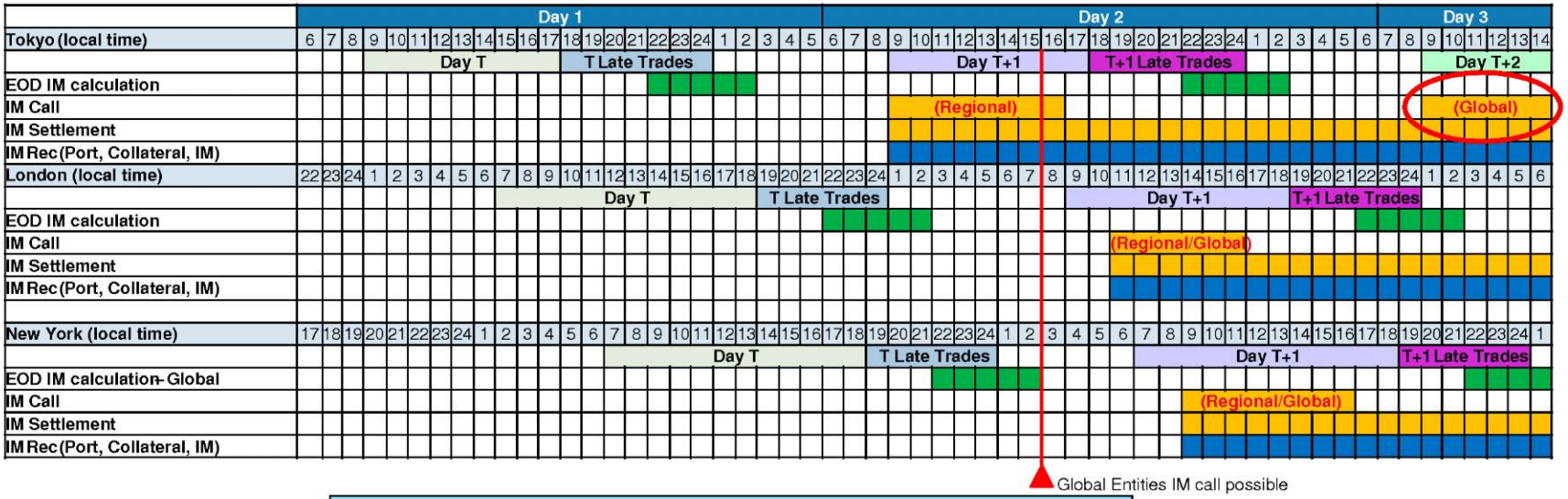
Appendix A
Counterparties in non-netting jurisdictions - list of jurisdictions and total gross notional %

Jurisdiction	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
ABU DHABI		0.0994%							0.0156%
ANDORRA		0.0003%			0.0004%	0.0009%		1.7083%	0.0197%
ANGOLA					0.0004%				0.0001%
ANTIGUA AND BARBUDA					0.0000%				0.0000%
ARGENTINA					0.0001%		0.0018%		0.0001%
BAHRAIN	0.0014%	0.0117%	0.0019%	0.0179%	0.0044%		0.2423%		0.0130%
BANGLADESH							0.0182%		0.0005%
BELIZE					0.0000%				0.0000%
BOTSWANA	0.0001%				0.0003%				0.0001%
BRUNEI DARUSSALAM					0.0053%		0.0599%		0.0024%
BULGARIA		0.0003%			0.0002%				0.0001%
BRUNEI				0.0024%		0.0031%			0.0009%
CHINA	0.1346%	0.1311%	0.4199%	0.2619%	0.1056%	0.2011%	0.6593%	0.8811%	0.1893%
COOK ISLANDS					0.0000%				0.0000%
COSTA RICA	0.0005%	0.0002%							0.0002%
COTE D IVOIRE	0.0005%	0.0004%			0.0043%		0.0912%	0.0120%	0.0033%
CROATIA		0.0027%		0.0104%	0.0011%	0.0008%			0.0030%
DJIBOUTI							0.0027%		0.0001%
DOMINICAN REPUBLIC								0.0001%	0.0000%
DUBAI		0.0160%							0.0025%
ECUADOR							0.0000%	0.0034%	0.0000%
EGYPT					0.0000%	0.0035%	0.0556%		0.0018%
ESTONIA	0.0000%	0.0003%			0.0001%				0.0001%
FRENCH POLYNESIA	0.0000%							0.0004%	0.0000%
FUJAIRAH		0.0003%							0.0000%
GAMBIA							0.0002%		0.0000%
GHANA		0.0004%					0.0058%		0.0002%
GEORGIA	0.0000%				0.0001%				0.0000%
GIBRALTAR	0.0001%	0.0044%			0.0008%				0.0008%
GUAM	0.0000%								0.0000%
HONDURAS	0.0002%	0.0015%					0.0042%		0.0004%
ISLE OF MAN		0.0068%			0.0005%	0.0011%			0.0013%
JORDAN		0.0003%			0.0000%		0.0391%		0.0010%
KAZAKHSTAN	0.0004%				0.0008%				0.0002%
KENYA		0.0038%					0.0087%		0.0008%
KIRIBATI							0.0012%		0.0000%
KUWAIT	0.0007%	0.0010%		0.0016%	0.0030%	0.0056%	0.0285%		0.0025%
LAO PEOPLE'S DEMOCRATIC REPUBLIC							0.0022%		0.0001%
LATVIA	0.0005%	0.0014%		0.0023%	0.0008%	0.0010%			0.0011%
LEBANON		0.0001%		0.0077%	0.0040%		0.0081%		0.0026%
LIBERIA	0.0007%	0.0013%			0.0067%	0.0013%			0.0017%
LIECHTENSTEIN	0.0207%	0.0148%		0.0133%	0.0179%	0.0027%	0.0133%		0.0150%
LITHUANIA	0.0011%	0.0016%		0.0020%	0.0003%	0.0019%			0.0013%
MACAU	0.0002%				0.0013%		0.0294%		0.0010%
MARSHALL ISLANDS	0.0005%				0.0030%	0.0030%	0.0006%		0.0010%
MONACO		0.0030%			0.0004%		0.0002%		0.0005%
MOROCCO		0.0044%		0.0020%	0.0002%		0.0209%		0.0017%
MOZAMBIQUE							0.0000%		0.0000%
NAMIBIA							0.0024%		0.0001%
NEPAL							0.0000%		0.0000%

Jurisdiction	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
NIGERIA	*0.0000%*	*0.0003%*			*0.0038%*		*0.0023%*		***0.0007%***
OMAN	*0.0029%*	*0.0000%*			*0.0010%*		*0.0999%*		***0.0035%***
PAKISTAN				*0.0023%*			*0.0282%*		***0.0012%***
PANAMA	*0.0007%*	*0.0017%*	*0.0008%*	*0.0050%*	*0.0067%*	*0.0032%*	*0.0121%*	*0.0565%*	***0.0040%***
PAPUA NEW GUINEA								*0.0000%*	***0.0000%***
PUERTO RICO	*0.0004%*	*0.0008%*			*0.0008%*	*0.0016%*			***0.0006%***
QATAR	*0.0043%*	*0.0188%*		*0.0037%*	*0.0039%*	*0.0051%*	*0.3305%*		***0.0145%***
RAS AL KHAIMAH		*0.0000%*							***0.0000%***
ROMANIA		*0.0001%*			*0.0003%*		*0.0013%*	*0.0077%*	***0.0002%***
RUSSIAN FEDERATION	*0.0109%*	*0.0608%*		*0.0426%*	*0.0066%*	*0.0114%*	*0.0678%*		***0.0263%***
SAINT VINCENT AND THE GRENADINES					*0.0000%*				***0.0000%***
SAMOA					*0.0000%*				***0.0000%***
SAN MARINO					*0.0000%*				***0.0000%***
SAUDI ARABIA	*0.0128%*	*0.0180%*		*0.0675%*	*0.0655%*	*0.0456%*	*1.2927%*		***0.0695%***
SENEGAL							*0.0085%*		***0.0002%***
SERBIA		*0.0000%*							***0.0000%***
SHARJAH		*0.0005%*							***0.0001%***
SRI LANKA							*0.0158%*		***0.0004%***
SUDAN					*0.0010%*				***0.0002%***
TRINIDAD AND TOBAGO					*0.0002%*				***0.0000%***
TURKMENISTAN				*0.0031%*					***0.0007%***
TUNISIA							*0.0009%*		***0.0000%***
UGANDA					*0.0000%*		*0.0000%*		***0.0000%***
UNITED ARAB EMIRATES	*0.0750%*		*0.1099%*	*0.0602%*	*0.0437%*	*0.0585%*	*2.2356%*		***0.1059%***
URUGUAY	*0.0002%*			*0.0018%*	*0.0000%*	*0.0586%*	*0.0132%*		***0.0073%***
VENEZUELA	*0.0017%*	*0.0006%*		*0.0039%*	*0.0082%*			*0.0246%*	***0.0031%***
VIETNAM							*0.0090%*	*0.0021%*	***0.0002%***
ZAMBIA							*0.0023%*		***0.0001%***
Non netting % of Total Gross Notional	***0.2711%***	***0.4091%***	***0.5326%***	***0.5117%***	***0.3042%***	***0.4099%***	***5.4160%***	***2.6963%***	***0.5247%***

Appendix B
IM Call Timing

The following illustrates a potential daily IM calculation and exchange proposal



Process

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

* Assumes use of Regional Market Data