

December 9, 2015

Department of the Treasury/Office of the  
Comptroller of the Currency  
**Docket No. OCC-2011-0008/RIN 1557-  
AD43s**

Board of Governors of the Federal  
Reserve System  
**Docket No. R-1415/RIN 7100 AD74**

Federal Deposit Insurance Corporation  
**RIN 3064-AE21**

Farm Credit Administration  
**RIN 3052-AC69**

Federal Housing Finance Agency  
**RIN 2590-AA45**

Addresses listed in Annex I

**Re: Docket No. OCC-2011-0008/RIN 1557-AD43s; Docket No. R-1415 /RIN 7100 AD74;  
RIN 3064-AE21; RIN 3052-AC69; RIN 2590-AA45**

**INTERPRETIVE ISSUES FOR MARGIN REQUIREMENTS FOR UNCLEARED SWAPS**

Ladies and Gentlemen,

The International Swaps and Derivatives Association<sup>1</sup> ("ISDA") appreciates the opportunity to submit this letter to request interpretations of the rules on uncleared swap margin. This request addresses issues that were discussed with representatives of the Prudential Regulators<sup>2</sup> (the "PRs") at our meeting on November 6, 2015.

These interpretations are critical for our members' current work on implementing the rules. We would therefore be grateful for a prompt response and we will follow up with you.

<sup>1</sup> 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](http://www.isda.org).

<sup>2</sup> The Prudential Regulators are: Treasury Department (Office of the Comptroller of the Currency); Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Farm Credit Administration; and Federal Housing Finance Agency.

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## 1) Time zone issues – day of execution:

**Proposal:** Covered swap entities ("CSEs") should be permitted to determine "day of execution" based on the timing of the calculation of the margin amounts for all swaps within a netting portfolio from the perspective of the counterparty who is last to calculate such margin amounts.

**Background:** Many CSEs trade swaps that are marked to market in multiple regions. For such swap books, the margin amounts are calculated in the last region to close on any business day. The call for margin cannot be made until the calculation is complete. Therefore, an adjustment for time zone differences should be made at the time of calculation of the relevant margin rather than when a swap is executed. Trying to determine the "day of execution" on a swap by swap basis would make it impossible for a CSE to adjust for time zones and call for margin on a portfolio basis for a business day.

The problem is illustrated by the following example: consider an entity trading Australian, Japanese, EU and US interest rate swaps or cross-currency swaps. The products will be marked in their respective time zones, for example Sydney close, Tokyo close, London close and New York close. The variation margin ("VM") call will be the netted amount of the change in value of all of the contracts and the initial margin ("IM") call will be the overall change in IM based on all the contracts, and so both calls can only be calculated once the trading books of the entity have closed in the last applicable time zone (which would be New York in the example above). The calculation will then be available to the operations team of the firm on the business day after trade date. For the margin call to be agreed between two firms, both operations teams must have performed the calculation.

By way of a more specific example, consider an Australian financial counterparty with a euro trade versus a European financial firm. Based on Monday's closing value, the European firm will issue a margin call to the Australian firm on Tuesday at 8 a.m. CET. However, the Australian firm will be outside office hours for Tuesday and only able to agree to the call on Wednesday morning Sydney time. Although this example focuses on a specific cross-border trade, financial firms are generally "cross-time-zone" by virtue of products traded and it would be difficult to segregate trades subject to potential time-zone issues from those not. The issues raised by parties in different time zones are illustrated by the chart in Exhibit A.

Moreover, our proposal would advance the policy goals of the rule, as described in the preamble. In describing the definition of "day of execution", the preamble states (p. 95): "... the final rule should provide adequate time for the covered swap entity to include the new swap in the regular initial margin cycle, under which the covered swap entity calculates the initial margin posting and collection requirements each business day for a portfolio of swaps . . ." (This language only refers to IM but the same timing concerns also apply to VM.) In order for the CSE posting and collection to be made on a portfolio basis for a business day, the time zone adjustment must be based on the time when the portfolio calculations are made.

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## 2) Notice to satisfy posting requirement:

**Proposal:** A CSE should be permitted to satisfy its posting obligation by delivering a notice, by the notification time (as defined below) on the business day after the day of execution, to its counterparty that the counterparty has the right to call for margin.

**Background:** A CSE is required to post VM to a counterparty and to post IM to a counterparty that is a financial end user with material swaps exposure. Secs. .3(b), .4(a), .6(e). However, a CSE cannot deliver margin unless the counterparty is ready to receive it and has given appropriate instructions to its custodian or bank. Exhibit B sets out the steps required for posting margin and potential difficulties if the CSE is required to deliver margin when the counterparty is not ready to receive the margin. These problems are exacerbated by the requirement to post margin by T+1.

We therefore propose that CSEs should be able to meet the posting requirement by delivering a notice, by the notification time on the business day after the day of execution, to the counterparty that it has the right to call for margin. The notification time is the latest time (as defined in the applicable agreement) that a call can be made for same-day settlement of margin. This proposal would provide CSEs with a operationally feasible way of posting that is consistent with the approach taken in Sec. .5(c), which provides that a CSE will not have violated its posting obligations if the counterparty fails to accept the margin obligations and the CSE makes the necessary effort to post the required margin. It would be impractical for a CSE to comply with the Sec. .5(c) requirement by, first, asking a counterparty on each day (after margin requirements have been calculated) whether the counterparty is willing and able to receive a collateral delivery; second, waiting for a response; and, third, posting margin within a T+1 timeframe.

## 3) Currency of settlement:

**Proposal:** Currency of settlement should be interpreted to include the termination currency, as defined in the applicable master agreement, as long as the termination currency is one of the currencies used to make payments on swaps governed by the master agreement.

**Background:** For VM, an additional 8% haircut applies if the VM is not in the "currency of settlement" of the swap, except for cash collateral in a major currency. Sec. . 6(c)(1)(i). "Currency of settlement" is defined as "a currency in which a party has agreed to discharge payment obligations related to a non-cleared swap, ... [or] a group of non-cleared swaps ... at the regularly occurring dates on which such payments are due in the ordinary course."

Using the termination currency is appropriate as a matter of policy because the termination currency is applied in a close-out. Collateral in the termination currency is not subject to a currency mismatch with the close-out amount and should not be subject to an additional 8% haircut for foreign exchange risk. The absence of a currency mismatch is implicitly recognized

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in the IM requirements, which do not impose an additional 8% haircut for IM denominated in the termination currency. VM should be treated in the same way as IM in this context.

In addition, use of the payment currency for an individual swap raises difficult issues for swaps. Margin for a single netting set is generally determined on a net, portfolio basis. Such netting is permitted under the rule if the swaps are governed by an eligible master netting agreement. If a swap portfolio includes swaps in different currencies, then the net amount of margin will be in a single currency. (In practice, this will typically be the termination currency.) If VM is subject to an 8% haircut based on the currency of individual swaps, then the parties will effectively be penalized for calling for VM on a net basis.

Another issue arises for swaps, such as cross-currency swaps, that settle in multiple currencies. Determining the settlement currency for such trades will be challenging: given multiple settlement currencies, the parties will have to agree for each such trade which currency is the currency of settlement.

Finally, use of a termination currency is consistent with the language of the "currency of settlement" definition if the termination currency is one of the currencies used for settlement of swaps under the master agreement. The rules provides that the currency of settlement is "a currency in which a party has agreed to discharge payment obligations related to ... a group of non-cleared swaps ... ." Based on this language, if a particular currency is used to settle some payments for a group of swaps, then it could be the currency of settlement for that group of swaps. Nothing in the definition suggests that a group of swaps must necessarily have only one currency of settlement.

\* \* \*

ISDA appreciates the opportunity to provide these proposals. As the PRs progress in their ongoing effort to implement the swap margin rules, we welcome the opportunity to assist. Please feel free to contact me at your convenience.

Sincerely,



Mary P. Johannes  
Senior Director and Head of ISDA WGMR Initiative  
**International Swaps and Derivatives Association, Inc. (ISDA)**

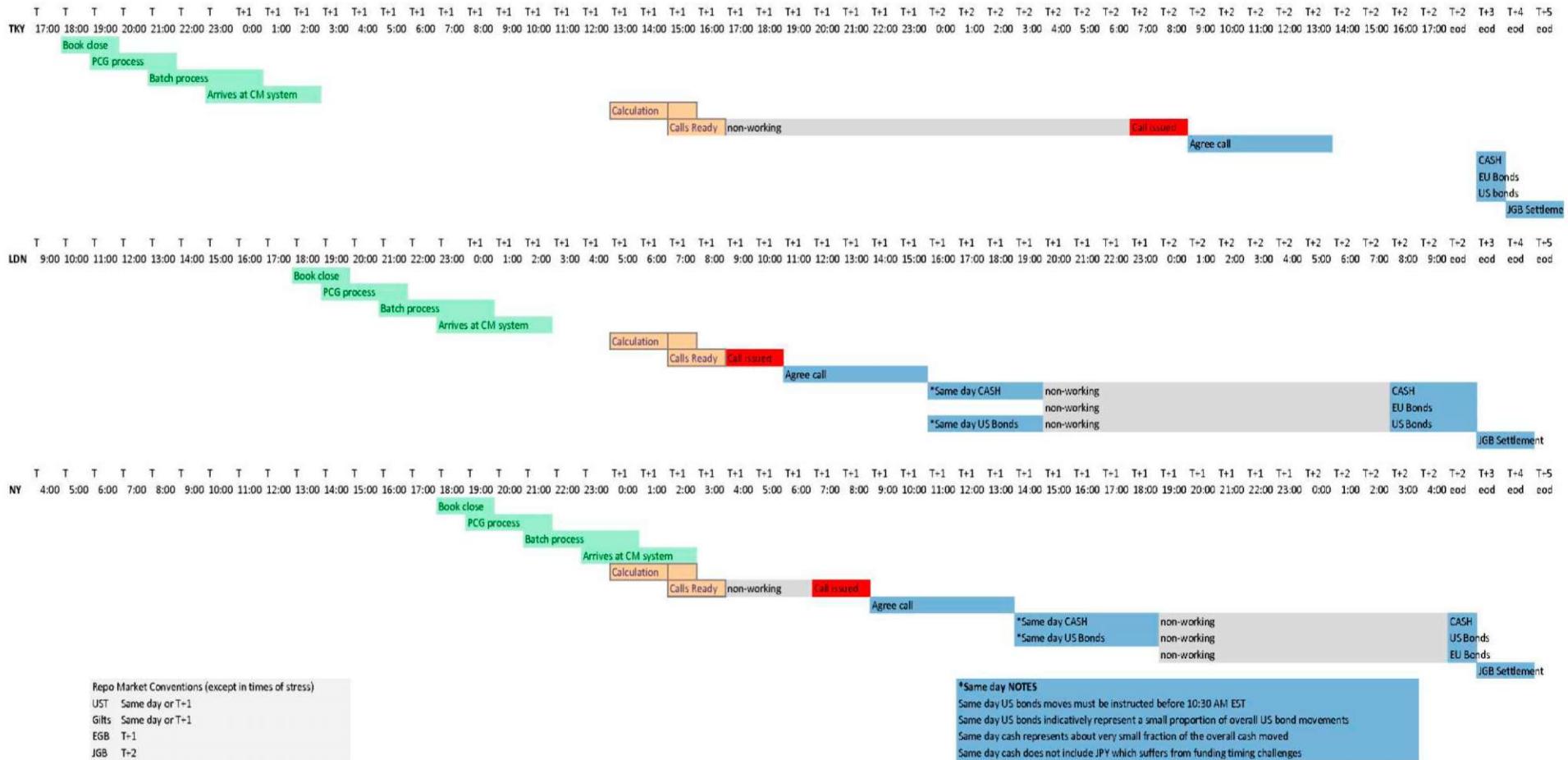
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## Annex I ADDRESSES

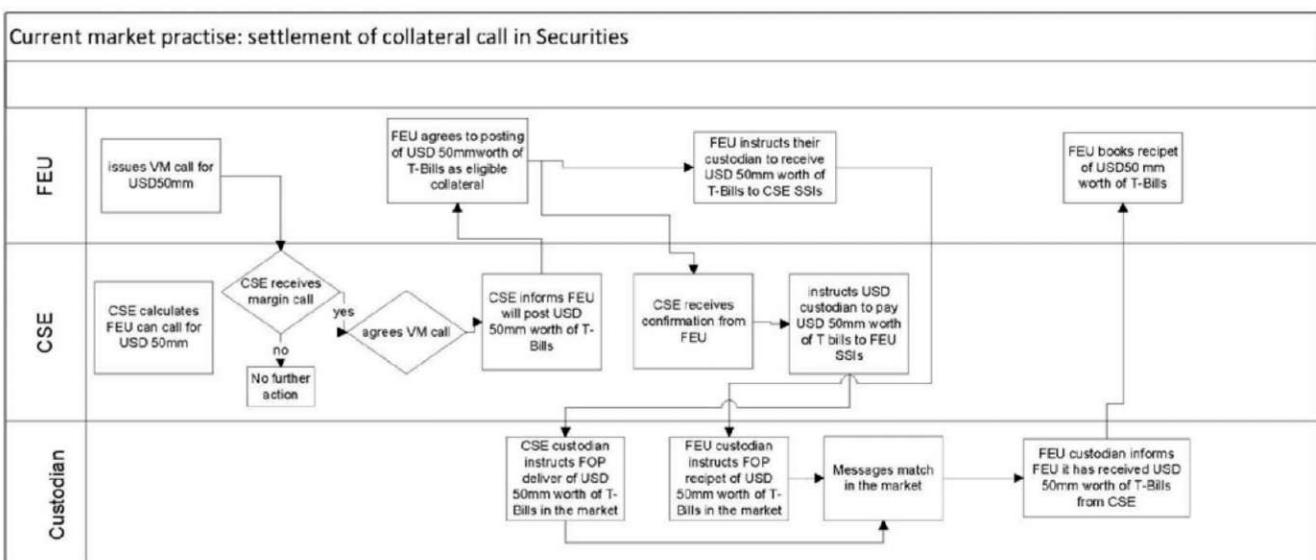
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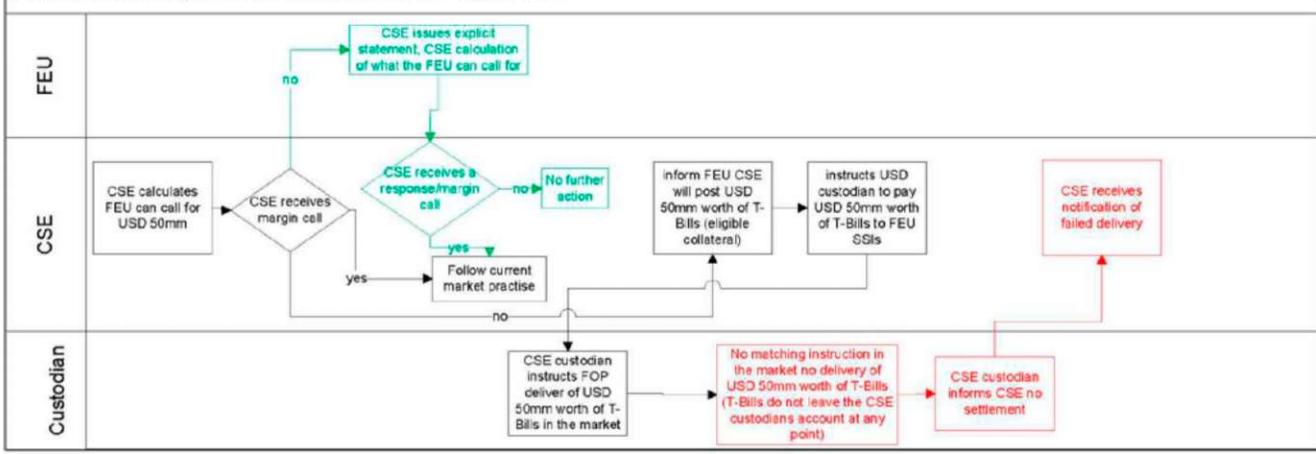
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### Current market practise: settlement of collateral call in Securities



### PR final rules: CSE posts USD 50mm worth of T-bills to FEU



**Key**  
 SSI: standard settlement instructions  
 FEU: Financial End User  
 CSE: Covered Swap entity  
 FOP: Free of Payment

Text in green: proposed industry solution  
 Text in red: implications of proposed rules

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