ISDA® Safe, Efficient Markets

June 13, 2016

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

Farm Credit Administration
RIN 3052-AC69

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

Federal Housing Finance Agency
RIN 2590-AA45

Federal Deposit Insurance Corporation
RIN 3064-AE21

Commodity Futures Trading Commission
RIN 3038-AC97

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; RIN 3038-AC97

<u>REQUEST FOR ALLOWANCE OF BROAD PRODUCT SETS FOR INITIAL MARGIN FOR SWAPS</u>

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") requests relief as described below for determination of the product set for initial margin ("**IM**").

Use of Broad Product Sets for Initial Margin

Request: A covered swap entity ("**CSE**") should be able to include out-of-scope products in its calculations of IM if those products are subject to the swap margin rules of a non-US regulator or another US regulator that are applicable to the counterparty of the CSE. Such out-of-scope products would be subject to IM and would be netted against swaps (assuming they are in the same asset class and subject to an eligible master netting agreement) for purposes of calculating IM.

[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.

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Discussion:

I. <u>Operational Difficulties</u>

In the absence of relief, in order to be in compliance with disparate rule sets, a CSE posting and collecting IM cross-border will have to post and collect the greater amount of IM required under US and non-US rules.

These "higher of" IM calculations will add significant complexity to the required trade documentation, IM calculations, and the margin and collateral processing operations of firms.

<u>Documentation</u>: Credit Support Annexes ("**CSAs**") will need to clearly state which product sets will be used in each set of calculations and how the "higher of" result will be used to determine the amount of IM. Firms operating through branches in multiple jurisdictions may need to agree to ISDA Master Agreements and CSAs (or other master netting and collateral agreements) at the branch level rather than at the current standard entity-level.

<u>IM Calculations</u>: An informal survey of Phase I ISDA member firms suggests almost half of those firms will not have completed by September 1, 2016 the build and testing of systems used to perform multiple IM calculations which take the “higher of” for each applicable rule set and to add additional regulation data to common risk interchange format (“**CRIF**”) files. Firms will need to modify their back-testing infrastructure to perform multiple tests calibrated for each counterparty pairing to accommodate IM requirements being driven on any given day by either set of rules.

<u>Margin and Collateral Processing</u>: The need to make "higher of" IM calculations will result in substantial technological burdens on the margin and collateral processing systems of CSEs, including but not limited to:

- Modifying the systems that read and categorize information from ISDA Master Agreements and CSAs or other similar agreements;
- Modifying trade-to-calculation mapping to ensure that the correct trades are fed into the correct IM calculations;
- Modifying margin call processes to adapt to differing sets of rules driving the IM calculations;
- Modifying systems to perform branch-level, rather than entity-level, calculations to mirror the corresponding ISDA Master Agreement and CSA arrangements if branch-level agreements are needed;
- Modifying feeds provided to third party vendors; and
- Modifying third party vendor services so that parties can track which calculations were used to drive margin calls when disputes arise.

Unless in-scope products are identical across US and non-US regulators, asymmetric product sets will present significant operational difficulties and provide little or no risk mitigation.

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II. Consistency with Other Jurisdictions' Margin Rules

The EU and Japan, the two largest jurisdictions (other than the US) to have adopted margin rules, both permit use of a broad product scope in calculating IM.[2] Under the EU rules, if a third-country counterparty's jurisdiction uses a definition of OTC derivative contracts that is different from that under EMIR, margin may be calculated for all contracts that meet either definition, provided that the third-country counterparty is subject to OTC derivative margin requirements under its own regulatory regime, and provided that a netting agreement between the EU counterparty and the third-country counterparty meets the same conditions as if both counterparties were domiciled in the EU.[3] The Japanese margin rules allow out-of-scope products to be included in the portfolio for the purpose of calculating IM on a counterparty-by-counterparty basis, as long as such products are included in the portfolio on an ongoing basis.[4]

III. Consistency with the PR and CFTC Margin Rules

The Preambles to the Prudential Regulators' (the "**PRs**") and the Commodity Futures Trading Commission's (the "**CFTC")** rules explain that the regulators do "not believe that it would be appropriate for margin requirements for [uncleared swaps] to be offset by netting other products or exposures across markets against other products that may present different concerns about safety and soundness or financial stability, or that are not subject to similar associated margin requirements."[5] ISDA members are asking for relief so that CSEs are able to include out-of-scope products in their calculations of IM if those products are subject to the swap margin rules of a non-US regulator or another US regulator that are applicable to the counterparty of the CSE. Such products raise very similar concerns about safety and soundness as those raised by swaps and are subject to similar margin requirements. Therefore, we do not believe that the language in the preamble prevents the use of a product set including such out-of-scope products (referred to below as a "broad product set"). The rules themselves do not explicitly prohibit the inclusion of products other than swaps for purposes of determining IM.[6] Finally, the use of a broad product set for IM is consistent with the purpose of the margin rules. The Preamble to the PR rules states that the margin standards imposed under Dodd-Frank "are intended to offset the greater risk to the swap entity and the financial system arising from non-cleared swaps".[7] Using a broad product set will result in additional products being subject to the IM rules, thereby reducing risk to swap entities and the financial system.

2 EU: European Supervisory Authorities "Final 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" ("**Final Draft RTS**"). 8 March 2016. Art. 5.; Japan: Cabinet Office Ordinance on Financial Instrument Businesses, etc. (Cabinet Office Ordinance No. 52 of 2007) ("**Cabinet Office Ordinance**"). Art. 123.7. We note that the EU rules are subject to further review by the European Commission.

3 Art. 5 of the Final Draft RTS.

4 Art. 123.7 of the Cabinet Office Ordinance.

5 CFTC: 81 FR 651; PRs: 80 FR 74 868, 9.

6 CFTC: Sec. 23.153(d); PRs: Sec. _.5(a).

7 80 FR 74841.

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IV. Requested Relief

ISDA is asking for use of a broad product set only for out-of-scope products which are subject to the swap margin rules applicable to the CSE's counterparty. The rules applicable to the counterparty could be issued by another US regulator or a non-US regulator. This relief would reduce the operational burden on CSEs and facilitate implementation without creating a significant increase in risk, and it is consistent with the margin rules of other jurisdictions.

In the event that the PRs and the CFTC do not grant this relief on a permanent basis, we request that it be granted until the PRs and the CFTC make an initial determination of substituted compliance with respect to transfers of IM for all jurisdictions which, at the time of this request, have adopted final margin rules consistent with the BCBS/IOSCO framework[8] (which are the EU, Japan, Canada and Switzerland). Substituted compliance may reduce the operational difficulties outlined above and will simplify the calculations that CSEs will have to make. Without even temporary relief, CSEs will have to build systems with a level of complexity that will become unnecessary upon a determination of substituted compliance with respect to transfers of IM.

In light of the above and the extensive implementation undertaking currently underway across the globe, we respectfully request prompt consideration of our request and stand ready to discuss these matters further with you at your earliest convenience.

* * *

Thank you for your consideration, and please contact me if you have any questions.

Sincerely,

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

[8] The margin framework for non-centrally cleared derivatives issued by the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**") in March 2015.

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Annex I

<u>ADDRESSES</u>

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