

**MEMO# 26529**

September 27, 2012

# **ICI and ICI Global Comment Letter in Response to Proposed Margin Requirements for Uncleared Derivatives by Basel Committee on Banking Supervision and IOSCO**

[26529]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 59-12  
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 51-12  
ICI GLOBAL MEMBERS  
INTERNATIONAL MEMBERS No. 38-12  
INVESTMENT ADVISER MEMBERS No. 30-12  
SEC RULES MEMBERS No. 83-12 RE: ICI AND ICI GLOBAL COMMENT LETTER IN RESPONSE TO PROPOSED MARGIN REQUIREMENTS FOR UNCLEARED DERIVATIVES BY BASEL COMMITTEE ON BANKING SUPERVISION AND IOSCO

ICI and ICI Global have submitted a comment letter to the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”) in response to their consultation document describing their initial proposal to establish minimum standards for margin requirements for uncleared derivatives. [\[1\]](#) The comment letter is attached and summarized briefly below.

In the letter, ICI and ICI Global express strong support for international efforts to implement consistent global standards for margin requirements for non-centrally-cleared derivatives. Given that many derivatives businesses are conducted across multiple jurisdictions, ICI and ICI Global also support efforts for real and meaningful coordination among regulators on how these regulations will be applied to market participants that operate cross border. In addition, the letter addresses several main areas related to margin requirements for uncleared derivatives.

## **Application of Margin Requirements to Series**

## **Companies**

The letter urges the BCBS and IOSCO to confirm that the margin requirements will apply at the fund or series level in recognition of the fact that the regulatory requirements generally apply at this level and to account appropriately for the potential counterparty risk associated with a particular derivatives transaction.

## **Scope of Coverage - Foreign Exchange Swaps and Forwards**

The letter argues that the risk profile for the FX swaps and forwards market is markedly different from other derivatives markets and warrants an exemption from margin requirements. The primary risk of FX swaps and forwards is settlement risk, and the predominant way of settling FX swaps and forwards ensures that the risk is essentially eliminated. The letter also expresses concern that subjecting these instruments to margin requirements could drain significant liquidity from global markets as a whole (given the volume of FX trading) and could threaten practices in the FX swaps and forwards market that help limit risk and ensure that the market functions effectively.

## **Two-Way Margin**

The letter strongly urges the BCBS and IOSCO to require counterparties to post margin at the same level and in the same manner. Two-way margin is an essential component of managing risk for derivatives transactions as well as for reducing systemic risk.

## **Use of Thresholds**

The letter agrees that the use of thresholds (the amount under which a firm would have the option of not collecting initial margin) may alleviate the potential liquidity impact of margin requirements for uncleared derivatives. The letter, however, cautions the BCBS and IOSCO to consider carefully the thresholds that would apply to various types of market participants to avoid creating an inappropriately unlevel playing field in this area. Specifically, the letter disagrees with the implication in the Consultation Paper that only “prudentially regulated entities” should benefit from a higher threshold. The letter recommends that the BCBS and IOSCO make the determination that an entity can apply a threshold on a different basis – ability to leverage or being subject to other type of substantive financial regulation – rather than basing the criteria on prudential regulation.

## **Calculation of Margin**

The letter supports the recommendation by the BCBS and IOSCO to permit the required amount of initial margin to be calculated by reference either to a quantitative portfolio margin model (subject to certain conditions) or a standardized margin schedule based on a percentage of notional exposure by asset class. As proposed, an initial margin model for uncleared derivatives would need to set initial margin at a level to cover 99 percent of price changes by product and portfolio over at least a 10-day liquidation horizon. The letter expresses concern that the 10-day liquidation period is too long for initial margin requirements.

# Forms of Margin

The letter agrees with the recommendation of the BCBS and IOSCO to permit a broad list of eligible collateral, would have the advantage of minimizing the potential liquidity impact of the margin requirements. The letter supports a broad set of eligible collateral to allow counterparties to a derivatives transaction the flexibility to agree upon the appropriate collateral that may be posted for a particular transaction.

## Treatment of Provided Margin

The letter strongly supports a requirement that collateral for uncleared derivatives transactions, in particular initial margin, be held by third-party custodians (i.e., tri-party arrangements) unless the posting party requests otherwise. In addition, the letter urges the BCBS and IOSCO to provide derivatives counterparties the opportunity to select a custodian that is not affiliated with a derivatives counterparty.

## Cross-Border Transactions

Given the practical difficulties in complying with two sets of margin requirements that may be duplicative or conflicting, the letter states that it is critical that global regulators have consistent and harmonized regulation with respect to margin. Where harmonization is not possible, global regulators should permit counterparties to agree in advance to comply with the requirements of a particular country as long as the jurisdiction regulates derivatives consistent with the G20 agreement.

Jennifer S. Choi  
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[Attachment](#)

### endnotes

[1] Margin Requirements for Non-Centrally-Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, July 2012, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD387.pdf> (“Consultation Paper”). For a summary of the Proposal, see ICI Memorandum No. 26325 (July 23, 2012), available at [http://www.ici.org/my\\_ici/memorandum/memo26325](http://www.ici.org/my_ici/memorandum/memo26325).