

MEMO# 26509

September 18, 2012

Draft ICI and ICI Global Comment Letter in Response to Proposed Margin Requirements for Uncleared Derivatives by BCBS and IOSCO; Member Comments Requested by September 24

[26509]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 31-12
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 50-12
ICI GLOBAL MEMBERS
INTERNATIONAL COMMITTEE No. 37-12
SEC RULES COMMITTEE No. 55-12 RE: DRAFT ICI AND ICI GLOBAL COMMENT LETTER IN
RESPONSE TO PROPOSED MARGIN REQUIREMENTS FOR UNCLEARED DERIVATIVES BY BCBS
AND IOSCO; MEMBER COMMENTS REQUESTED BY SEPTEMBER 24

The Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”) issued a consultation document describing their initial proposal to establish minimum standards for margin requirements for uncleared derivatives. [\[1\]](#) ICI and ICI Global have prepared a draft comment letter, which is attached. If you have comments on the draft letter, please provide them to Jennifer Choi at jennifer.choi@ici.org by Monday, September 24.

The draft letter expresses strong support for international efforts to implement consistent global standards for margin requirements for non-centrally cleared derivatives. The draft letter addresses several main areas related to margin requirements for uncleared derivatives, as described below.

Application of Margin Requirements to Certain Market Participants

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 marketplace and 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 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 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 supports the recommendation of the BCBS and IOSCO to permit a broad list 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. The letter

agrees with the BCBS and IOSCO that a broad set of eligible collateral would have the advantage of minimizing the potential liquidity impact of the margin requirements.

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) with restrictions on rehypothecation and reinvestment unless the parties determine 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
Senior Associate Counsel – Securities Regulation

[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”).