THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

1001 PENNSYLVANIA AVE., NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-628-2507

RICHARD M. WHITING
EXECUTIVE DIRECTOR AND
GENERAL COUNSEL

By Electronic Mail

July 11, 2011

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
RIN 1557-AD43
Docket ID OCC–2011–0008

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G St NW, 4th Floor
Washington, DC 20552
RIN 2590-AA43

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, D.C. 20551
RIN 7100 AD74
Docket No. R–1415

Gary K. Van Meter
Acting Director
Office of Regulatory Policy
Farm Credit Administration
1501 FarmCredit Drive
McLean, VA 22102–5090
RIN 3052–AC69

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments/Legal ESS
RIN 3064–AD79

RE: Margin and Capital Requirements for Covered Swap Entities

Ladies and Gentlemen:

The Financial Services Roundtable[1] (the "Roundtable") respectfully submits these comments in response to the proposal (the "Proposal")[2] by the Office of the Comptroller

[1] The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $ 92.7 trillion in managed assets, $ 1.2 trillion in revenue, and 2.3 million jobs.

[2] 76 Fed. Reg. 27564 (May, 11, 2011)

of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (collectively, the "Agencies") to establish margin and capital requirements for prudentially regulated swap dealers and major swap participants under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3] We appreciate the opportunity to comment.

Title VII requires that the Agencies jointly establish margin and capital requirements for "covered swap entities"—swap dealers, security-based swap dealers, major swap participants and major security-based swap participants—in connection with uncleared swaps. Mandating the collection or posting of margin (or setting capital levels) is expected to add new costs and risks for many market participants. It is critical to evaluate those costs and risks to determine whether they are justified in light of the potential benefits to the system they are intended to create. In particular, costs that reduce the availability of hedging to end-users or make swaps too expensive or too risky may increase systemic risk rather than reducing it. As with many other aspects of the Dodd-Frank Act, the margin provisions will affect different market participants in different ways, and a tailored approach is essential to minimize undue adverse effects and to protect vulnerable market participants. We appreciate the efforts the Agencies have made to adopt a graduated approach based on the perceived risk of the applicable swaps transactions, and many of our comments are intended to further refine elements that are already included in the proposal.

I. Swaps between covered swap entities and financial entities.

A. We support less stringent requirements for transactions with low-risk financial entities as opposed to high-risk financial entities, and believe that the criteria for low-risk financial entities should be modified.

The Agencies have proposed a three-part test to identify entities that should be considered low-risk financial entities. These entities must:

(a) not have significant swaps exposure,

(b) predominantly use swaps to hedge, and

(c) be subject to capital requirements established by a prudential regulator or a state insurance regulator.

The central condition in this analysis is whether the swaps are being used predominantly to hedge. The regulatory system established under Title VII generally acknowledges that swaps used for hedging purposes are inherently less risky than other swaps,[4] and we agree that the use of a swap for hedging should be a core aspect to determining whether a financial entity may be classified as low risk. We believe that the other two criteria

[3] Pub. Law No. 111-203, § 939A, 124 Stat. 1887 (July 21, 2010).
[4] See, e.g., Dodd-Frank Act, Section 723, which conditions the commercial end-user exemption from mandatory clearing on the use of the swap for hedging purposes.

should act as alternative, rather than joint, conditions. An entity that is subject to capital requirements established by a prudential regulator or a state insurance regulator and that is using swaps predominantly to hedge should not present the type of risk that would justify requiring margin in all circumstances. Moreover, the Agencies have proposed a limit on the threshold that would be available even to low-risk financial end-users, so that even if such an entity had significant swaps exposure it should not have such exposure to any single covered swap entity. Similarly, an entity that uses swaps predominantly to hedge and that does not have significant swaps exposure, even if not subject to regulatory capital requirements, should be considered low-risk, especially given the proposed limitation on the threshold for low-risk financial entities. Accordingly, we believe the proposed definition should be revised to allow thresholds greater than zero for financial entities that satisfy either conditions (a) and (b), or conditions (b) and (c), but not all three conditions.

B. The threshold permitted for transactions with low-risk end financial users should not be limited by dollar amount and should be tied to Tier 1 capital as of the date of the agreement.

The Agencies have proposed thresholds for margin that would be the lesser of a specified dollar amount (between $15 million and $45 million) and a percentage of the Tier 1 capital of the covered swap entity. Although we appreciate the approach of limiting the thresholds to a percentage of Tier 1 capital—effectively ensuring that no one counterparty relationship places a significant portion of the covered swap entity's capital at risk—our members have expressed concern that the threshold must be set at the time the agreement is executed, rather than fluctuating with the covered swap entity's Tier 1 capital. We request that the Agencies clarify that the proposed restrictions are intended to be used to determine a dollar-amount for the threshold, but are not intended to mandate that the threshold refer to a formula based on Tier 1 capital.

In addition, the specified dollar amount component of the threshold seems arbitrary at best. The proposed numbers seem to be grounded neither in a determination of the ability to create systemic risk nor in the attributes of either the covered swap entity or the low-risk financial entity. We therefore recommend that this prong of the threshold limitation be dropped.

C. Preservation of ability to negotiate two-way posting of margin.

The Agencies' proposal does not require the posting of margin by covered swap entities to their financial end-user counterparties. However, under current market practice, two-way posting of variation margin between covered swap entities and financial end-users can be negotiated between the parties as a matter of contract. We interpret the Agencies' proposal to have no impact on this market practice. If the current proposal is adopted, we would expect this market practice to continue.

D. Sovereign governments should be treated as commercial end-users rather than as financial entities, with no set limits.

We do not believe sovereign governments are appropriately correlated with financial entities in terms of risk and exposures. They are a separate category, with their own unique attributes related to their tax base, natural resources, political structure, demographics and a myriad of other factors unrelated to financial systems generally. Moreover, they have a wide range of options in terms of swap counterparties, and will likely eliminate from consideration any U.S. entities that offer adverse financial terms relative to other market participants. Finally, we believe it is likely that the European Union will specifically exempt its member sovereigns from complying with the margin requirements, which would create a further competitive disadvantage for U.S. covered swap entities. We therefore believe that the proposed treatment of such entities is inappropriate and will cause significant competitive harm to covered swap entities. We urge the Agencies to reconsider this position.

II. The allowable forms and processes for segregation of margin should be expanded.

The forms in which margin can be held for transactions between covered swap entities, or between covered swap entities and financial entities, are too restrictive and should also include, at a minimum, high-quality corporate debt and money market funds with an appropriate haircut.[5] We recognize that the restrictions imposed by the Dodd-Frank Act on the use of credit ratings in federal regulations may be constraining the ability to rely on what has been the traditional method of determining whether an investment was high quality. We do not believe, however, this constraint justifies restricting the options available to covered swap entities and their counterparties to such a narrow range of choices. Other means to determine the quality of an obligation can include a board determination, similar to that used by Rule 2a-7 funds under the Investment Company Act (including a board determination that includes consideration of credit ratings), or an analysis of trading characteristics such as spread to US treasury bonds or volatility. In addition, the permitted forms of margin should be the same for initial margin and variation margin, and so should include Fannie Mae, Freddie Mac and other agency residential mortgage backed securities even for variation margin.[6]

We also believe that other accommodations should be considered to avoid the decline in efficiency involved in having to post collateral separately for back-to-back swaps. It is typical for a bank or a small swap dealer to hedge its exposure to a customer swap by entering into a back-to-back swap with another swap dealer. If the customer posts margin to a bank or small dealer, for instance, and elects to have that margin segregated, under the Proposal the bank or small dealer would have to post a similar

[5] See part III below for a discussion of the forms of margin that should be permitted for transactions with commercial end-users.

[6] We also have concerns about supply to the extent that a very narrow range of assets may be permitted not only under this regulation but under others, such as those addressing liquidity reserves as part of enhanced regulatory capital requirements. We believe the Agencies should consider the cumulative effect of multiple regulations that require financial institutions to hold the same very limited types of assets for a variety of purposes.

amount of margin to a covered swap entity that was the swap dealer for its hedging swap. As a result, the total margin is likely to be twice as high for the swap exposure as it would be if the margin were not segregated. One possible way to address this would be to permit the intermediate bank or small swap dealer to post its swap agreement with its customer as collateral for its hedging swap, rather than separately posting margin. If the intermediate entity defaults, the swap dealer for the hedging swap can step into its position with respect to the customer swap. And if the customer defaults, the intermediate entity can use the amount received from the customer, including through use of its margin, to replace the margin for the second swap. All parties are protected, but the margin is only segregated once. We believe this would be a much more efficient approach.

Finally, we believe that covered swap entities should have discretion as to whether and where margin posted by them will be segregated. The decision to require segregation of margin can increase the cost of a transaction and add operational burdens, and covered swap entities should be permitted to analyze these matters in light of potential counterparty risk. Moreover, we do not believe covered swap entities should be restricted to using custodians subject to the same insolvency regime so long as they have evaluated the risks of using a particular custodian. We also believe the reference to the insolvency regime is intended to mean the same national regime. Otherwise this would preclude entities potentially subject to resolution under the Federal Deposit Insurance Act, for instance, from using the same custodian as would be required for an entity subject to the Bankruptcy Code, potentially making some custodial arrangements impossible.

Similar issues would apply to cross-border transactions generally. We believe the most critical issues with respect to the legal framework applicable to the custodian are (i) whether, in the event of the insolvency of the custodian, custodial assets would not become part of the insolvency estate of the custodian and (ii) whether a court located in the jurisdiction of the custodian would respect the parties' choice of law in determining rights with respect to the custodial assets. These issues should be analyzed by a covered swap entity in consultation with its legal counsel, but should not be the subject of a bright-line rule.

III. Swaps between covered swap entities and commercial end-users.

A. Covered swap entities should have the ability to establish agreements pursuant to which commercial end-users are not at risk of margin calls.

The Agencies have proposed to allow covered swap entities to set margin thresholds for commercial end-users based on a credit assessment, but even where such a threshold did not require the posting of margin at the effective date of the transaction, the proposal would not allow covered swap entities to preclude the possibility of subsequent margin calls. For many commercial end-users, the possibility of a margin call would create a significant risk that at best would require changes in liquidity management and at worst would preclude them from hedging entirely.

We appreciate the Agencies' concerns that covered swap entities act prudently in making swap facilities available to their customers, and we recognize that the decision to set a threshold greater than zero is effectively a credit determination. Banks and other financial institutions, however, are generally careful to structure their financial arrangements with their customers in ways that do not present the risk of payment shocks or other unexpected obligations under such financial arrangements. For many commercial end-users, a margin call would have the effect of a payment shock, increase the risk of default, and contribute to systemic risk. For others, such as project finance entities or other commercial end-users that have limited cash flows, margin calls would create significant logistical difficulties and might, for instance, necessitate a separate credit facility to provide the liquidity for margin calls. We fail to see the value in having a bank lend under one facility in order to allow a customer to obtain the cash collateral necessary to meet a margin call under a swap.

We note that the CFTC has proposed a more flexible approach to this issue and would not require the swap entities subject to its oversight to require margin calls from commercial end-users. We believe this is both a more appropriate approach and one that, as discussed in Section II.C. below, will lead to a competitive advantage for such swap entities over those subject to prudential regulation by the Agencies. We therefore ask that the Agencies rules be brought into alignment with the CFTC proposal on this point.

B. The Agencies should allow much greater flexibility in the forms of margin permitted for commercial end-users.

Banks and other financial institutions make judgments about the value of collateral every time they provide a secured loan. We are not aware of any reason that they should be less able to do so in the context of margin requirements than in the context of loans, nor of any reason that the risks associated with the posting of margin should be viewed as greater than those associated with secured loans. It is common for a swap entered into in connection with a loan—a category that Congress specifically excluded from the determination of whether an entity was a swap dealer[7]—to be secured by the same collateral that secures the loan. We believe the Agencies should preserve the ability of covered swap entities to accept a broad range of collateral in connection with the margin requirements for commercial end-users, and to allow such entities to accept the same security for swap obligations that they accept for loans from a customer.

We note that the Agencies have suggested that commercial end-users could obtain the necessary cash to post as margin by borrowing under a credit agreement secured by a broader range of assets. We do not believe such an approach would be efficient or effective to reduce risk, and we see no reason to add another layer of complexity to an economically equivalent transaction. In addition, we are concerned that such an approach might not be feasible for some commercial end-users, for which it might violate restrictive covenants in debt agreements. The CFTC has taken a much broader approach, allowing the use of any asset "for which the value is reasonably ascertainable on a

[7] See the proviso to Section 1a(49)(A) of the Commodity Exchange Act, as added by Dodd-Frank Act, Section 721.

periodic basis in a manner agreed to by the parties in the credit support arrangements."[8] We therefore urge the Agencies to take a broad view of permissible forms of margin, comparable to that of the CFTC, in this context.

C. If no margin is required, no credit support annex or similar documentation should be required.

If, as we request, the proposed rules are revised to allow covered swap entities to establish agreements in which margin will not be required, we believe that documentation of the credit support arrangements should also not be required. The process of agreeing a credit support annex may be very unfamiliar to many commercial end-users, and is a time-intensive endeavor. We believe that such a requirement would be both confusing and burdensome to end-users. Even where credit support documentation is required because margin is, or may be, required, we ask that the Agencies clarify that an ISDA-form credit support annex is not required. Instead, parties should be able to use a more conventional pledge agreement.

D. It is important that the conditions under which margin is held for commercial end-users not differ depending on whether the swap dealer is subject to prudential regulation or CFTC oversight, as this will create significant competitive inequalities.

Section 731 of the Dodd-Frank Act, adding Section 4s(e)(2) to the Commodity Exchange Act, specifically requires the Agencies to establish the margin regulations in consultation with the CFTC and the SEC. Moreover, these provisions further require that the Agencies, the CFTC and the SEC "to the maximum extent practicable, establish and maintain comparable minimum capital requirements and minimum initial and variation margin requirements, including the use of non cash collateral, for—(I) swap dealers; and (II) major swap participants."[9] We do not believe that the margin requirements as currently proposed by the Agencies and the CFTC satisfy that statutory directive. As drafted, the Proposal and the CFTC's margin proposals would create significant competitive disadvantages for banks and other prudentially regulated financial institutions, without any safety and soundness considerations that justify such distinctions. Even where differences in approach may lead to the same economic result, such as the Agencies' proposal to allow end-users to borrow under a secured facility to obtain cash collateral for posting, we believe the complexity of these provisions will discourage commercial end-users from relying on covered swap entities that are subject to the Agencies' rules. We believe the more flexible approach proposed by the CFTC is the more appropriate of the two proposals with respect to these requirements, and we urge the Agencies to conform to that approach.

[8] 76 Fed. Reg. at 23747.
[9] Commodity Exchange Act, Section 4s(e)(3)(D)(ii).

IV. Treatment of pre-effective date swap transactions.

We strongly support the Agencies' decision not to impose margin requirements on pre-effective date swaps. Making such changes on a retroactive basis would significantly change the economics of outstanding transactions and would require extensively negotiated amendments with counterparties. Because the volume of an entity's existing legacy swaps far outstrips the number of any new transactions it may enter, extending margin requirements to pre-effective swaps would also require costly modifications to an entity's internal collateral monitoring system which may be unfeasible. We believe, therefore, that it is neither appropriate nor viable to impose such a requirement on outstanding trades.

We also believe the proposal to allow netting of initial margin on a portfolio-wide basis under a qualifying master netting agreement, taking into account only those swaps entered into after the effective date, is appropriate. In some cases, though, the parties may agree that they would prefer to engage in true portfolio-wide netting, including pre-effective date trades as well as post-effective date trades. We believe this should be permitted. However, to the extent pre-effective date transactions are included in such portfolio margining, we believe the margin associated with those trades should be determined based on the terms originally negotiated by the parties, rather than being tied to the requirements of the Proposal (which would require, among other things, a formal amendment and counterparty consent). Such a determination should extend to the form of the margin as well as to the amount. Thus, portfolio-wide margining that included pre-effective date trades would likely include a mix of methodologies to determine the relevant margin requirements and permit a broader range of collateral for use as margin for pre-effective date swaps. We believe this is both the most appropriate and the most efficient result where parties decide to include such pre-effective date swaps in the netting determinations.

Finally, we believe the proposal to require netting of variation margin on a portfolio-wide basis under a qualifying master netting agreement, taking into account all swaps (including those entered prior to the effective date) is also appropriate given current market conventions. Again we believe that the determination and form of variation margin with respect to pre-effective date swaps should be made in accordance with the terms of such outstanding swaps, rather than using the new regulatory standards.

V. The Proposal should integrate alternative means for the calculation and collection of margin.

We support the Agencies' proposal to allow parties to establish initial margin either by using a look up table or by using an internal model that has been approved by the applicable regulators.[10] We also believe that the Agencies should allow, as additional options, those proposed by the CFTC. The CFTC would allow determination of margin by reference to cleared swaps where comparable cleared swaps exist and would permit

[10] We believe the proposed minimum transfer amount of $100,000 is reasonable and should not create operational difficulties.

the use of third-party models if those are made commercially available. Although some of the conditions the CFTC has proposed with respect to such options may make them too cumbersome or expensive, we believe that properly crafted versions of these options could add important flexibility for market participants. Permitting a variety of approaches will allow counterparties who are negotiating margin requirements with covered swap entities to choose the model which is either the most transparent or the one with which they have the greatest level of familiarity. Because the Proposal addresses margin for uncleared swaps, the means by which such margin is calculated may well be a matter of negotiation. The Agencies should help facilitate that negotiation.

We also believe that the use of the look up table should be better tailored to reflect offsetting risks, as in the example presented by the Agencies where the requirements for a two-year fixed/floating swap would be netted against those for a one-year floating/fixed swap, rather than treated as additive. As the Agencies have observed, the current approach set forth in the Proposal will lead to significant competitive disadvantages for covered swap entities that are relying on the look up table rather than an internal model. At a minimum, the table should be tailored so that positions that fully or largely offset each other are netted, rather than summed, to avoid unnecessary costs.

The proposals with respect to the calculation of variation margin, including the requirement to include such calculation in the trade documentation for the swap, appears to be sufficiently flexible to accommodate existing market practice, and we therefore support the Agencies' version of this proposal. We would be concerned, however, if these provisions were adopted or interpreted to incorporate documentation of valuation methodology as proposed by the CFTC,[11] which would require a level of detail that is inconsistent with current practice and is likely to be impossible to implement.. We also support the proposed safe harbor for covered swap entities that are unable to collect variation margin because a counterparty refuses or fails to provide it as required, which we read to provide protection when there has been a breach, and also under circumstances in which there is a bona fide dispute over the amount of such margin.

VI. Qualifying master netting agreements.

We are concerned that a number of the proposed provisions to define a qualifying master netting agreement, and a number of the restrictions on netting suggested in the Proposal, would prevent netting in circumstances in which it should be permitted or would cause it to operate inefficiently or in an administratively burdensome manner without a corresponding benefit. The following are some of our key concerns on this point:

a) Clause (2) of the proposed definition would require that "The agreement provides the covered swap entity the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral

[11] See Commodity Futures Trading Commission, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732, 23734 (April 28, 2011), referencing Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 FR 6715 (Feb. 8, 2011).

promptly upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions." We are concerned that the proviso, which does not allow the exercise of rights to be stayed, may conflict with certain aspects of the orderly liquidation authority granted to the FDIC under Section 210 of the Dodd-Frank Act or other provisions of relevant insolvency law that impose brief delays on the exercise of such rights and may prevent such exercise where the rights under the agreement are transferred to a bridge institution or other entity;

b) The proposal to allow models to include provisions that only recognize "offsetting exposures, diversification, and other hedging benefits within four broad risk categories" will add unnecessary complexity, restrict the usefulness of netting agreements, and create added costs for market participants without yielding a corresponding benefit. The process of tracking netting along such category lines would also be extremely difficult to manage operationally, and could potentially add settlement risk. Netting across product lines should be permitted as long as it is consistent with legal certainty.

c) To the extent such arrangements can be documented with sufficient legal certainty, netting should be permitted across cleared and uncleared exposures of the same counterparty. For example, if a swap dealer is indemnifying a clearing agency on behalf of a customer, and is also collecting margin in connection with uncleared swaps, netting should be permitted.

d) To the extent such arrangements can be documented with sufficient legal certainty, netting should be permitted across affiliated entities.

e) Clause (5) of the proposed definition would require that the agreement not contain provisions that allow a lower payment or no payment to a defaulting party, even where that party is a net creditor under the agreement. We appreciate that the Agencies want to ensure that such provisions are not punitive, i.e., that they do not extinguish valuable rights based on a default. However, we believe there are circumstances in which such provisions, which may be part of ISDA and other standard forms, are appropriate, especially where there may be additional rights of set-off available to the counterparty in connection with separate agreements between the non-defaulting and defaulting party. We believe the provision needs to be drafted more narrowly to allow the exercise of such set-off rights.

f) There are potential legal issues for state-regulated insurance companies that are domiciled in some states with respect to the "well-founded basis" to conclude that netting agreements are enforceable in an insurer insolvency proceeding. Although the market has become comfortable with these issues from a risk perspective, agreements with insurance companies domiciled in these states may not technically be "qualifying master netting agreements" under the Proposal, which would significantly increase the cost of hedging for insurance companies in affected jurisdictions. The provisions of the Insurance Receivership Model Act with respect to qualified financial contracts are intended to address the legal certainty point, but not all states have adopted this or similar legislation.

g) The proposal should clarify that collateral associated with foreign currency swaps and forwards, even though such agreements are expected to be carved out of the general provisions of Title VII, should nonetheless be permitted to be included in a qualifying master netting agreement.

VII. Capital requirements.

We agree with the agencies' conclusion that the existing risk-based capital rules already address the capital implications of swap transactions for prudentially regulated financial institutions, and the determination that the expansion of those rules to address specific risks is not necessary. Accordingly, we support the approach set forth in the Proposal with respect to capital.

VIII. Extraterritorial application.

We agree that there must be a limit to the extraterritorial application of Title VII, and we believe that where covered swap entities that are not U.S. entities engage in transactions with other non-U.S. entities, those transactions should not be subject to the margin requirements set forth in the Proposal. However, the exception as proposed is too narrow, in that it would subject non-U.S. entities that are affiliated with U.S. entities to the same margin requirements as if they were U.S.-based. As a result, such affiliates would be at a significant competitive disadvantage when entering into swaps with non-US entities. To avoid such adverse competitive effects, we believe the definition of foreign covered swap entity should be broadened so that affiliation is not relevant.

IX. Intercompany transactions.

We believe intercompany transactions should be exempt from all margin requirements. Corporate groups may find it more efficient to have a single entity engage in swaps activities with external parties, and in such circumstances may use back-to-back intercompany swaps to allocate the swap economics among various affiliates. Little benefit would come from requiring margin to be posted within an affiliated group. Intercompany transactions between entities subject to prudential regulation and their affiliates are subject to existing restrictions under Sections 23A and 23B of the Federal Reserve Act and the regulations thereunder. These restrictions are sufficiently robust to eliminate any need for a specific margin requirement for affiliate transactions. We therefore encourage the Agencies to provide an express exemption from the requirement for a covered swap entity to collect margin when it is dealing with an affiliate.

X. Certain entities that may otherwise be characterized as financial entities should instead be treated as commercial end-users for purposes of these provisions.

There are a number of types of special purpose vehicles that potentially could be determined to be financial entities for purposes of the Proposal that we believe should instead be treated as if they were commercial end-users. For example, it is common for securitization vehicles to enter into swaps to hedge the interest rate or currency risk of a pool of assets. For nonrevolving asset pools, all such swaps would be customarily entered into concurrently with the issuance of the securities, and would amortize as the underlying assets amortize. For revolving master trusts, swaps might be entered into concurrently with a new issuance of securities, but the master trust would not be expected to enter into swaps at other times. In either circumstance, the swap counterparty would be entitled to cash flows from, and would be secured by, the asset pool. The swaps used by these securitization vehicles usually have the following characteristics:

- They are unleveraged interest rate or currency swaps;
- They are structured to match the terms of the securities issued by the vehicle with the terms of the assets held by it;
- They are entered into to hedge risk;
- Their notional amount never exceeds the notional amount of the underlying assets; and
- They are issued by a vehicle that is prohibited from incurring debt other than in connection with the securitization.

It will be difficult for securitization vehicles to respond to margin calls. The cash flows on their assets are usually distributed on a monthly basis, not daily or weekly. Providing either a separate liquidity facility or a funded cash collateral account to facilitate margin calls will increase the cost of meeting those margin calls substantially, and may place additional pressure on the credit ratings of the securitization. Securitization vehicles are already preparing for new and costly risk retention requirements that are intended to improve the quality of securitized assets; adding an additional cost to provide cash margin to protect a swap that is already fully secured will further restrict the utility of this funding source without a commensurate reduction in risk to the covered swap entity. We believe the better approach is to allow covered swap entities to conduct a credit evaluation of these vehicles and their assets at the time of entry into the swap, and then set discretionary initial margin requirements, without requiring any mark-to-market adjustments over time.[12]

XI. Interplay with Section 716 swaps push out rule.

A number of our members who may have to push all or part of their swaps activity out to an affiliate as a result of Section 716 of the Dodd-Frank Act are particularly concerned about the lack of uniformity between the rules proposed by the Agencies and those proposed by the CFTC. It is important that swaps market participants

[12] Alternatively, we believe these entities should be treated as low-risk financial entities, with a threshold not to exceed a percentage of the covered swap entity's Tier 1 capital, but again with no obligation to post variation margin.

that are moving from prudential regulation to CFTC oversight (or SEC oversight, if applicable) avoid having to first implement the Proposal and then undergo a second change in regulations and procedures as a result of regulatory differences. In addition, there is a need for regulatory consistency to ensure that swaps activity that is divided between a prudentially regulated entity and a separate swaps affiliate can be conducted in comparable ways across both entities. We therefore urge all sets of regulators to work together to bring the proposed requirements into closer alignment.

XII. The timing of final implementation.

The Agencies have proposed that the new margin regulations would become effective 6 months after the date of adoption of the final regulations. We believe this will not allow sufficient time for most covered swap entities to bring their swaps businesses in line with the new requirements. Implementing these changes will include (1) determining the appropriate categorization of counterparties, (2) developing and testing models, (3) making systems changes, (4) updating operations, (5) negotiating custodial arrangements, and (6) modifying standard forms of CSAs. In addition, the new margin regulations will be part of a much more dramatic change in the regulatory landscape related to swaps activity, including a panoply of new registration, clearing, exchange trading, recordkeeping and reporting requirements being concurrently promulgated by the CFTC and the SEC. These margin regulations will need to be coordinated with the efforts of those agencies to avoid costly inefficiencies such as having to renegotiate swaps documentation multiple times with the same counterparty. We therefore believe that the 6 month implementation period suggested by the prudential regulators is not only far too short, but also needs to be integrated into the timing of effectiveness of the broader Title VII rulemaking process. We ask that the Agencies take an alternative approach to the effective date that better reflects these concerns.

Because implementation of the margin requirements will be particularly time and document-intensive, it may be necessary for the Agencies to employ a phased-in approach. For instance, final implementation deadlines for margin requirements rules could first cover agreements between two swap dealers or major swap participants, then agreements including high-risk financial entities, then agreements including low-risk financial entities, and then finally swap agreements including commercial end-users.

* * * * * *

The Roundtable and its members appreciate the opportunity to comment to the Agencies on the Proposal with respect to margin regulations for covered swap entities. If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org. Please also feel free to contact the Roundtable's Senior Regulatory Counsel, Brad Ipema, at Brad.Ipema@fsround.org.

Sincerely yours,

Richard M. Whiting
Executive Director and General Counsel
The Financial Services Roundtable