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Via Electronic Submission:

Department of the Treasury
Office of the Comptroller of the Currency (OCC)
Docket No. OCC–2011–0008
RIN 1557–AD43
250 E Street, SW
Mail Stop 2-3
Washington, D.C. 20219
regs.comments@occ.treas.gov

Board of Governors of the Federal Reserve System
Docket No. R–1415
RIN 7100 AD74
Robert deV. Frierson, Secretary
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
regs.comments@federalreserve.gov

Federal Deposit Insurance Corporation
RIN 3064–AD79
Robert E. Feldman, Executive Secretary
550 17th Street, NW
Washington, D.C. 20429
comments@fdic.gov

Farm Credit Administration
RIN 3052–AC69
Gary K. Van Meter, Director
Office of Regulatory Policy
1501 Farm Credit Drive
McLean, VA 22102-5090
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Federal Housing Finance Agency
RIN 2590–AA45
Alfred M. Pollard, General Counsel
400 Seventh Street, NW, Eighth Floor
Washington, D.C. 20024
regcomments@fhfa.gov

Re: Margin and Capital Requirements for Covered Swap Entities (the "Proposing Release")

Ladies and Gentlemen:

We appreciate this opportunity to comment on the rules proposed by the Department of the Treasury, 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 "Prudential Regulators") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") relating to margin requirements for non-cleared swaps for "covered swap entities" (as defined in the Proposing Release) (the "Proposed Rules").[1] We provide our comments from the perspective of financial end users of derivatives and specifically of "high-risk financial end users of derivatives," as such term is defined in the Proposed Rules. Along with both buy- and sell-side institutions, we support the Prudential Regulators' efforts to reduce risk and promote stability in the U.S. financial system, while also maintaining a robust market for cleared and non-cleared swaps to suit the varying needs of a wide range of market participants.

Our comments primarily focus on the Proposed Rules governing swaps between covered swap entities (referred to herein as "CSEs"), on the one hand, and high-risk financial end users of derivatives, on the other hand. As described in more detail below, we respectfully request that the Prudential Regulators: (i) require bilateral exchange of initial and variation margin; (ii) permit parties to negotiate appropriate thresholds for initial margin; (iii) expressly permit netting of initial margin for non-cleared swaps and netting of initial margin across cleared and non-cleared swaps; and (iv) require tri-party custodial arrangements for initial margin for all swaps between a CSE and its counterparties and include a provision allowing a counterparty to a CSE to take control of collateral in the tri-party account upon the CSE's bankruptcy or insolvency.

As a general matter, we support the Prudential Regulators' efforts to balance the Act's goals of reducing risk by promoting central clearing (and, where clearing is not available, implementing measures to reduce risks associated with non-cleared swaps) with the need to maintain active buy-side participation in our markets. However, we remain concerned that, from the perspective of those large, sophisticated buy-side participants that have implemented their own extensive risk

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[1] Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27564 (May 11, 2011); 77 Fed. Reg. 60057 (Oct. 2, 2012) (extending comment period).

management, some of the requirements suggested by the Prudential Regulators will unduly increase both the cost and risk of transacting with CSEs. This may have significant adverse effects both on the investment activities of these buy-side investors, and on the stability and depth of the financial markets in general.

As our major institutional investors invest on an international scale, we support the Prudential Regulators' efforts to harmonize its regulations with those in other jurisdictions, most notably the policy recommendations set forth by the Basel Commission on Banking Supervision and the International Organization of Securities Commissions Working Group on Margin Requirements ("WGMR").[2]

I. Mandatory Bilateral Exchange of Initial and Variation Margin

In proposed §§__.2 - __.4, the Prudential Regulators address initial and variation margin for non-cleared swaps between CSEs and financial end users of derivatives. Proposed §§__.2 and __.3 would require CSEs to collect initial and variation margin from financial end user counterparties (subject to a zero threshold with respect to high risk financial end users), but not to pay initial or variation margin to such counterparties. Bilateral exchange of initial and variation margin is a key principle in the Basel Report, and bilateral exchange of variation margin is a nearly uniform market practice today.

We join the WGMR and other market participants in encouraging the Prudential Regulators to require bilateral posting of initial and variation margin in swaps between CSEs and financial end users. First, bilateral exchange of margin will have the effect of reducing systemic risk in the financial markets and limiting the amount of unsecured exposure between swap counterparties. Bilateral exchange of variation margin addresses actual current mark-to-market exposures (*i.e.*, losses) between counterparties and its daily exchange helps to avoid accumulation of large, uncollateralized losses that a party may not be able to cover during a time of significant market stress. It is standard market practice for parties to swap transactions to exchange bilateral variation margin. Requiring the bilateral exchange of variation margin would reinforce this sound market practice, causing little disruption to the market. In addition, because non-cleared swaps in many cases will tend to be more customized and therefore less liquid than their cleared counterparts, failing to remove current exposures in connection with such swaps through bilateral exchange of margin could exacerbate losses in the event of a default by the CSE (because such swaps might be more difficult and/or expensive to liquidate), particularly during a time of significant market stress.

Likewise, we urge the Prudential Regulators to require bilateral posting of initial margin. We believe that one-way posting of margin will, in addition to the problems discussed previously, distort the swaps market and have the effect of discouraging central clearing of swaps. Under the

[2] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, Consultative Document, Margin Requirements for Non-Centrally-Cleared Derivatives (July 2012) (the "Basel Report").

Proposed Rules, initial margin required from a financial end user in its non-cleared swaps with a CSE generally will be higher than initial margin for cleared swaps. Furthermore, CSEs will be required to post initial and variation margin for cleared swaps, but will able to avoid legally-imposed margin requirements altogether in connection with non-cleared swaps. Allowing dealers not only to collect more initial margin for non-cleared swaps than cleared swaps, but also to avoid having to post initial or variation margin to their counterparties could incentivize dealers to try to structure transactions to avoid central clearing, where the CSE will be able to collect less initial margin from its counterparty and will be required to post initial and variation margin.

In the Proposing Release, the Prudential Regulators discuss the relative amounts of risk that financial end users and nonfinancial end users pose to CSEs in support of its imposition of initial and variation margin requirements on the former but not the latter. We do not agree that all financial end users necessarily pose greater risk to CSEs than all nonfinancial end users, or that a financial end user necessarily poses greater risk to a CSE than the CSE poses to the financial end user. To be sure, in many of the cases in which we are involved, the counterparty to the CSE is more creditworthy than the CSE itself, whether measured by credit ratings or other relevant objective criteria. For this and the other reasons noted above, we respectfully request that the Prudential Regulators require bilateral posting of initial and variation margin in swaps between CSEs and financial end users.

II. Thresholds for Initial Margin

Under proposed §§__.2 - __.4, CSEs would be required to collect initial and variation margin from high-risk financial end user counterparties, subject to a zero threshold and a minimum transfer amount of $100,000. A limited exception to the zero threshold is available for swaps between a CSE and a "low-risk financial end user." However, the exception will not be available to a significant category of large institutional investors because it requires, among other things, the financial end user to be subject to capital requirements established by a prudential regulator or a state insurance regulator. The Proposed Rules do not adequately identify financial end users that have different levels of risk. Furthermore, we believe that thresholds are appropriate in the context of initial margin, whereas full exchange of variation margin is generally required to protect against the accumulation of large uncollateralized losses. Instead of following a one-size-fits-all approach, we urge the Prudential Regulators to give parties to non-cleared swaps more discretion to determine whether, and to what extent, a threshold will apply to initial margin. As the Prudential Regulators are aware, even within the so-called "high-risk financial end user" category, there exists a wide variety of size, sophistication, experience, creditworthiness and financial resources. To assume that nearly all financial end users pose the same amount of risk – and therefore should be required to post the same amount of initial and variation margin – ignores this variety, leaving those sophisticated and creditworthy financial end users that have robust risk management practices with disproportionate amounts of capital tied up with their CSE counterparties (while receiving no initial

or variation margin in return). It is difficult to understand how this scenario serves to reduce risk or promote stability in the financial system.[3]

The Basel Report states that "it may be desirable to apply different threshold amounts to different types of derivative market participants"[4] but stops short of proposing how such thresholds should be derived. The Prudential Regulators ask a number of questions in the Proposing Release on this subject, including whether "the definitions adequately identify financial end user counterparties that are high-risk and low-risk."[5] We respectfully submit that parties to non-cleared swaps where one party is a financial end user[6] should be permitted to use thresholds that are determined by contract and customized by the parties to the swap, and otherwise subject to a maximum threshold amount that would apply across the universe of financial end users. We believe that the parties to the swap – especially where the parties have had a longstanding trading relationship – are in the best position to evaluate each other's creditworthiness and to determine an appropriate threshold amount for initial margin.

III. Netting of Initial Margin

Proposed §__.4(d) expressly permits parties to calculate variation margin requirements on an aggregate basis across all swap or security-based swap transactions that are executed under the same qualifying master netting agreement. This is consistent with current market practice among many market participants (*e.g.*, pursuant to master netting agreements), allowing them to efficiently deploy capital while ensuring that overall exposure to a counterparty is appropriately collateralized.

The Proposed Rules permit parties to net initial margin only in limited circumstances. Specifically, the Proposed Rules permit parties to net initial margin only where the CSE uses an approved initial internal margin model and where the relevant swaps or security-based swaps are conducted under a qualifying master netting agreement. Where the CSE does not use an approved internal initial margin model and instead uses the table set forth in Appendix A of the Proposed Rules, the initial margin calculation will be based upon the specified percentage of gross notional amounts and will not recognize any offsetting exposures, diversification, or other hedging benefits. We respectfully urge the Prudential Regulators to clarify in the final rules that parties may net initial margin. Clarifying in the final rules that parties may net initial margin would be consistent with the Proposed Rules governing variation margin and current industry best practice.

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[3] It can, of course, be argued that all large derivatives traders pose more systemic risk and are more likely to impact the market during times of financial stress than other types of investors. However, even within the category of large derivatives traders, there exist many entities that have strong risk management and compliance resources, and long-term experience and sophistication in derivatives trading, and, though large, in practice pose little threat to the overall financial system due to their resources, abilities to absorb losses, objectives and methods.
[4] Basel Report at 10.
[5] Proposing Release at 27572.
[6] We agree with and support the Prudential Regulators' proposal to allow the parties to swaps between a CSE and a nonfinancial end user to determine initial and variation margin requirements and applicable thresholds.

In addition, we respectfully urge the Prudential Regulators to clarify in the final rules that CSEs and their counterparties may net initial margin between cleared and non-cleared swaps. The Proposed Rules are unclear on this issue. Many market participants currently have the ability to net initial margin between cleared and over-the-counter transactions through the use of master netting agreements. As mentioned previously, these netting arrangements allow parties to provide an amount of margin that appropriately reflects overall exposure to a counterparty.

IV. Custodial Arrangements

Sections 724 and 763 of the Act require a CSE to offer its swap and security-based swap counterparties the option of requiring segregation of initial margin posted to the swap entity with an independent third-party custodian. The Proposed Rules require CSEs to segregate initial margin only when the CSE's counterparty is itself a swap entity; no such requirement exists with respect to counterparties that are not swap entities. We respectfully urge the Prudential Regulators to apply the segregation requirement in the Proposed Rules to all counterparties of a CSE. Many of the reasons the Prudential Regulators cite in support of mandatory segregation with respect to noncleared swaps between CSEs and swap entities exist with respect to all of a CSE's counterparties. As noted in the Proposing Release, "the failure of a [CSE] could pose significant systemic risks to the financial system [which] could have significant consequences," and "[t]he consequences could be magnified if the initial margin posted to the failing [CSE] cannot be quickly recovered by the nondefaulting party during a period of financial stress when the liquidity value of the funds is high."

Furthermore, as currently drafted, the Proposed Rules do not specify the circumstances under which a party would be entitled to take control of the margin, and instead leave this to negotiation between the parties. We respectfully request that the Prudential Regulators require in §__.7 that, at a minimum, a party is entitled to control of the margin subject to the agreement without delay to the extent the CSE becomes bankrupt or insolvent. This is a key principle in the Basel Report, which states that "collected margin must be subject to arrangements that fully protect the posting party in the event that the collecting party enters bankruptcy to the extent possible under applicable law."[7]

In our experience, this term is frequently negotiated in tri-party arrangements governing initial margin accounts. We believe that adding such a requirement to the Proposed Rules would contribute to stability in the financial system by protecting customer margin in the event of a bankruptcy or insolvency by a CSE, without disrupting current market practice.

We appreciate the Prudential Regulators' attention to these comments.

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[7] Basel Report at 25.

Sincerely yours,

/s/ Christopher A. Klem
Christopher A. Klem

/s/ Leigh R. Fraser
Leigh R. Fraser

/s/ Molly Moore
Molly Moore