

Via Email

November 13, 2014

Legislative and Regulatory Activities Division  
Office of the Controller of the Currency  
400 7<sup>th</sup> Street, SW  
Suite 3E—218  
Mail Stop 9W—11  
Washington, DC 20219

*Re: Margin and Capital Requirements for Covered Swap Entities*

Dear Sirs/Madams:

The purpose of this letter is to provide you with the Council of Institutional Investors' (Council) views on the proposed rulemaking entitled "Margin and Capital Requirements for Covered Swap Entities" (Proposed Rule).<sup>1</sup> As you are aware, the Council is a nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of American workers.<sup>2</sup>

### **Treatment of Swaps with Commercial End User Counterparties**

The Council opposes the Proposed Rule's provision that "[u]nlike the 2011 proposal, . . . *does not require* a covered swap entity to collect initial margin and variation margin from nonfinancial end users and certain other parties as a matter of course."<sup>3</sup> As one official has commented, the provision "amounts to 'essentially status quo for commercial end users.'"<sup>4</sup>

We do not believe the status quo is acceptable. We agree with former Federal Reserve Chairman Ben Bernanke that "making derivatives safer is a very important part of solving too-big-to-fail."<sup>5</sup>

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<sup>1</sup> Prop. Treas. R. Docket ID OCC—2011—0008, R—1415 & RIN 7100—AD74, RIN 3064—AE21, RIN 3052—AC69, RIN 2590—AA45, 79 Fed. Reg. 57,348 (Sept. 24, 2014), <http://www.occ.gov/news-issuances/federal-register/79fr57348.pdf>.

<sup>2</sup> For more information about the Council of Institutional Investors (Council) and our members, please visit the Council's website at [http://www.cii.org/about\\_us](http://www.cii.org/about_us).

<sup>3</sup> 79 Fed. Reg. at 57,358 (emphasis added).

<sup>4</sup> Victoria McGrane, *Regulators Unveil New Version of Swaps-Margin Rule*, Wall St. J., Sept. 3, 2014, at 1, <http://online.wsj.com/articles/regulators-unveil-revised-swaps-margin-rule-1409753420>.

<sup>5</sup> S. Rep. No. 111—176, at 29 (Apr. 30, 2010) (footnote omitted), [http://www.banking.senate.gov/public\\_files/Committee\\_Report\\_S\\_Rept\\_111\\_176.pdf](http://www.banking.senate.gov/public_files/Committee_Report_S_Rept_111_176.pdf).

Moreover, it continues to be our view that making derivatives safer requires that *all* over-the-counter derivative transactions, including those with non-financial end users, should be subject to margin requirements.<sup>6</sup> We note that our view is consistent with the recommendations of the Investors Working Group (IWG).<sup>7</sup> In its 2009 seminal report on U.S. financial regulatory reform, the IWG concluded:

A federal regulatory regime is needed for any continuing OTC market . . . . All OTC trades should be subject to federally imposed margin requirements, and all large market participants should be subject to capital requirements.<sup>8</sup>

The dangers of permitting covered swap entities to decide whether or not to collect *any* margin from nonfinancial end users was described in the legislative history to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act).<sup>9</sup> More specifically, the legislative history of the Act states:

“The main tool for regulating contagion and systemic risk is . . . margin . . . .” In the OTC market, margin requirements are set bilaterally and do not take account of the counterparty risk that each trade imposes on the rest of the system, thereby allowing systemically important exposures to build up without sufficient capital to mitigate associated risks. The problem of under-collateralization is especially apparent in bank transactions with *non-financial firms* and regulators should address this problem through the new margin requirements . . . .

. . . While large losses are to be expected in derivatives trading, if those positions are fully margined there will be no loss to counterparties and the overall financial system and none of the uncertainty about potential exposures that contributed to the panic in 2008.<sup>10</sup>

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<sup>6</sup> Letter from Justin Levis, Senior Research Associate, Council of Institutional Investors, to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System 1 (June 22, 2011) (“The Council believes that swaps and security based swaps involving a nonfinancial end user should not be exempt from margin requirements, as requiring margin reduces risk to taxpayers and to the financial system.”), [http://www.federalreserve.gov/SECRS/2011/June/20110624/R-1415/R-1415\\_062211\\_81353\\_413848970611\\_1.pdf](http://www.federalreserve.gov/SECRS/2011/June/20110624/R-1415/R-1415_062211_81353_413848970611_1.pdf).

<sup>7</sup> The Investors’ Working Group, U.S. Financial Regulatory Reform: The Investors’ Perspective 10-12 (July 2009), [http://www.cii.org/files/issues\\_and\\_advocacy/dodd-frank\\_act/07\\_01\\_09\\_iwg\\_report.pdf](http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf).

<sup>8</sup> *Id.* at 11.

<sup>9</sup> S. Rep. No. 111—176, at 33.

<sup>10</sup> *Id.* (emphasis added and footnote omitted).

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More recently, in the *Journal of Applied Corporate Finance*, Professors Mello and Parsons explain how the failure to require margin for derivative transactions with non-financial end users may effectively result in “taxpayers . . . subsidiz[ing] the . . . risk in non-margined derivatives.”<sup>11</sup> We believe bank regulators have an obligation to remove this subsidy and the related risk from the backs of American workers and retirees by requiring margin in swap transactions with commercial end user counterparties.

We appreciate the opportunity to provide our views on the Proposed Rule. If you have any questions or need any additional information, please feel free to contact me at (202) 261-7081 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,



Jeff Mahoney  
General Counsel

CC: Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System (via email)  
Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation (via email)  
Alfred M. Pollard, General Counsel, Federal Housing Finance Agency (via email)  
Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration (via email)

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<sup>11</sup> Antonin S. Mello & John E. Parsons, MIT Center for Energy and Environmental Policy Research, *Margins, Liquidity, and the Cost of Hedging*, 25 J. Applied Corp. Fin. 34, 35 (Winter 2013) (The existence of a taxpayer subsidy assumes that if, as proposed, margin is not required for counterparties with nonfinancial end-users, over time industry practice will evolve and margin will not be provided for any of those transactions—a result that Professors’ Mello and Parson believe would likely occur.), [http://web.mit.edu/ceepr/www/publications/reprints/Reprint\\_250\\_WC.pdf](http://web.mit.edu/ceepr/www/publications/reprints/Reprint_250_WC.pdf).