September 14, 2015

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, CFTC RIN 3038-AC97.[1]

Dear Mr. Kirkpatrick:

The American Bankers Association[2] (ABA) and ABA Securities Association[3] (ABASA) appreciate the opportunity to provide comments on the Commodity Futures Trading Commission's (CFTC) re-proposed rule governing the cross-border application of margin requirements applicable to non-prudentially regulated swap dealers (SDs) and major swap participants (MSPs) (collectively, Covered Swap Entities or CSEs). We appreciate the effort of both the CFTC and Prudential Regulators[4] in largely harmonizing their proposals, and we encourage the Prudential Regulators to consider these comments as they finalize their over-the-counter (OTC) swaps margin rules.[5]

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[1] 80 Fed. Reg. 41376 (July 14, 2015) (the CFTC Cross-Border Margin Proposal).

[2] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.

[3] The ABA Securities Association is a separately chartered affiliate of the American Bankers Association, representing those holding company members of the American Bankers Association that are actively engaged in capital markets, investment banking, swap dealer and broker-dealer activities.

[4] For purposes of this letter, the Prudential Regulators are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration.

[5] This letter is in direct response to the CFTC's Cross-Border Margin Proposal and our specific recommendation related to an "emerging market" exception is thus focused on situations where the CFTC's rules apply (i.e., a non-prudentially regulated U.S. CSE or a Guaranteed non-U.S. CSE transacts with an emerging market counterparty). The Prudential Regulators are also finalizing their OTC margin rules. Accordingly, we recommend that the "emerging market" exception framework described below be applied to U.S.-based banking organizations, however they are operating in emerging markets, including, but not limited to, through a foreign branch of a prudentially-regulated CSE. U.S. banks often operate in emerging markets only through foreign branches and without an exception, these U.S. banks may be effectively locked out of these jurisdictions. 79 Fed. Reg. 57348 (Sept. 24, 2014) (the Prudential Regulators' Proposal).

Banking organizations and their customers use swaps to manage and mitigate the risks inherent in everyday business transactions. Margin requirements must be carefully tailored so as not to make it difficult or impossible for banking organizations to continue to serve customers that use swaps to hedge the interest rate, currency, and credit risks that arise from their loan, securities, and deposit portfolios, as well as the value that banks derive from using derivatives to manage their risk exposures to their customers. We have consistently supported the objectives of increasing transparency and appropriate supervision of swaps and other financial products of systemic importance. However, it is critical that regulatory implementation of these objectives preserve the ability of banking organizations to compete globally and to serve as engines for economic growth and job creation by providing long-term credit to both domestic and foreign businesses.

Overview

The Dodd-Frank Act mandates that the CFTC take a risk-based approach to imposing margin requirements on SDs and MSPs engaging in uncleared swaps and security-based swaps.[6] The statute also requires regulators to impose requirements to: (i) help ensure the safety and soundness of the SD or MSP, and (ii) be appropriate for the risk associated with uncleared swaps.

Recognizing the global nature of the uncleared swaps market and the value of consistent international standards for margin requirements for uncleared swaps, in September 2013, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), in consultation with the Committee on Payment and Settlement Systems (CPSS) and the Committee on the Global Financial System (CGFS), published key objectives, elements and principles of a final margining framework.[7] Against this backdrop, the CFTC and Prudential Regulators re-proposed margin rules for implementation in the U.S.[8]

Swaps markets are global in nature. Without harmonized regulatory approaches, these markets are particularly vulnerable to migration away from regulated entities. Throughout the swaps rulemaking process, we have encouraged the regulators to be mindful of the competitive and market implications of their cross-border regulatory initiatives on the various business structures through which U.S.-based banking organizations conduct business overseas. The efforts of the U.S. regulators to harmonize the substance and timing of margin requirements with

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[6] Section 731 also applies to the Securities and Exchange Commission (SEC), which is required to establish margin requirements for SBS dealers and major SBS participants. The SEC issued a Notice of Proposed Rulemaking on November 23, 2012 (Capital, Margin, and Segregation Requirements for SBS Dealers and Major SBS Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70214 (Nov. 23, 2012)), before the issuance of the BCBS-IOSCO Final Framework.

[7] BCBS-IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013) (the BCBS-IOSCO Final Framework).

[8] After the publication of the BCBS-IOSCO Final Framework, the European Union published a Consultation Paper on “Draft regulatory standards on risk mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012” (Apr. 14, 2014) (the EU Proposal).

key foreign regulators via the BCBS-IOSCO process is a significant step to reduce competitive disparities and conflicting requirements and to ensure an orderly implementation of final rules. However, the CFTC Cross-Border Margin Proposal continues to take an unnecessarily broad extraterritorial scope as well as diverge from the BCBS-IOSCO Final Framework in ways that foster competitive discrepancies and conflicting obligations and do not adequately take into account the costs of the proposed approach. In particular, we reiterate the following points that were included in our previous comment letter:[9]

- The CFTC should permit market participants to rely on substituted compliance based on comparable rule sets to the greatest possible degree across the markets in and structures through which they operate.

- The CFTC should incorporate a *de minimis* exception for swap activities conducted in jurisdictions for which substituted compliance is not available, similar to the "emerging markets" exception promulgated by the CFTC in its Cross-Border Guidance.[10]

- To help streamline implementation efforts and allow opportunity for coordination, the CFTC should provide sufficient time for foreign jurisdictions to establish margin requirements prior to enforcing final margin rules. This will enable the CFTC to issue comparability determinations on other jurisdictions' margin rules.

<u>Margin Rules Should Include an Exception for U.S. Entities Transacting with Counterparties in Emerging Markets</u>

We recommend that the CFTC and the Prudential Regulators incorporate an "emerging market" exception into their final OTC margin rules. We believe an exception that imposes direct limits on the percentage of activity a U.S. CSE or Guaranteed non-U.S. CSE[11] can engage in as result of its trading activities with emerging markets counterparties can achieve the same policy outcome of OTC margin rules at less cost and significantly less disruption. We also believe that such an exception is statutorily permissible. Since the activities in emerging markets represent a *de minimis* amount of the total derivatives activity by a CSE, setting a direct limit on the percentage of total notional activity incurred by derivatives activities in these jurisdictions would sufficiently support the statutory goals of ensuring the safety and soundness of the CSE and protecting the financial system against risks associated with uncleared swaps.

There are three key reasons why an emerging market exception should be adopted. First, the activities in emerging markets jurisdictions represent a *de minimis* portion of the U.S. CSEs' and Guaranteed non-U.S. CSEs' total derivatives activity. Second, legal and operational constraints will likely make compliance with OTC margin rules in emerging market jurisdictions

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[9] ABA Comment Letter to Multiple Agencies on Uncleared Swaps Margin (Nov. 24, 2014), *available at* http://www.aba.com/Advocacy/commentletters/Documents/11-24-14CommentLettertoJointAgenciesreUnclearedSwapsMargin.pdf.

[10] 78 Fed. Reg. 45,292 (July 26, 2013).

[11] As described in the CFTC Cross-Border Margin Proposal, a "Guaranteed non-U.S. CSE" is a non-U.S. CSE whose obligations under a swap are guaranteed by a U.S. person.

difficult, if not impossible. Third, the costs of foreclosing U.S. entities' access to these markets outweigh the risks mitigated by the application of OTC margin rules in these jurisdictions.

The risks posed by derivatives transactions with counterparties in emerging markets to the U.S. CSE or U.S. guarantor of a non-U.S. CSE are typically *de minimis* relative to the U.S. CSE's or U.S. guarantor's overall derivatives activity. We believe that the alternative of imposing a direct limit on the percentage of activity that a U.S. CSE or Guaranteed non-U.S. CSE is allowed to incur as result of its trading activities with emerging markets counterparties could achieve the same policy outcome as OTC margin rules at less cost and significantly less disruption to markets and customers.

The legal frameworks in many of these jurisdictions do not recognize the concepts of netting, security interest, or segregation. The local banking sector may lack the operational infrastructure to support the daily exchange of margin and the third-party custodial relationships required to comply with initial margin segregation requirements. Additionally, if OTC margin rules are mandated in emerging markets, initial margin may be required to be held with inexperienced local custodians, introducing a new custodial risk.

U.S.-based banking organizations compete with regional actors in emerging markets. U.S. CSEs and Guaranteed non-U.S. CSEs often enter into derivatives transactions with counterparties located in emerging markets in connection with an associated commercial or investment banking activity in those foreign jurisdictions. For example, a CSE may enter into a swap transaction with a borrower in connection with a loan made to that borrower. In a standard type of financing structure, a CSE (or its affiliate) offers a borrower a floating rate loan and the borrower hedges the interest rate exposure through interest rate swaps. Additionally, if the loan is in a foreign currency vis-à-vis the borrower's local currency, the borrower may enter into a non-deliverable foreign exchange forward transaction with the CSE (or its affiliate) to hedge the resulting currency exposure. Therefore, if accommodations are not made for U.S. entities transacting in these foreign markets, these U.S. entities will be inhibited in their ability to compete effectively with regional actors and will likely lose not only derivatives business, but also associated commercial and investment banking relationships.

Accordingly, we recommend the following emerging market exception[12] be incorporated in the final OTC swaps margin rules:[13]

- Scope. The "emerging market" exception should be available to any arrangements through which a U.S.-based banking organization transacts with an emerging market counterparty.
- Definition of Emerging Market Counterparty. An "emerging market" counterparty should be defined as a non-U.S. person that is not a registered CSE, guaranteed by a U.S.

[12] *See* footnote 5, *supra*.

[13] The framework is consistent with the SIFMA/IIB comment letter submitted in connection with this proposal.

person, or located in a jurisdiction covered by a comparability determination for uncleared swaps margin rules issued by the Commission.[14]

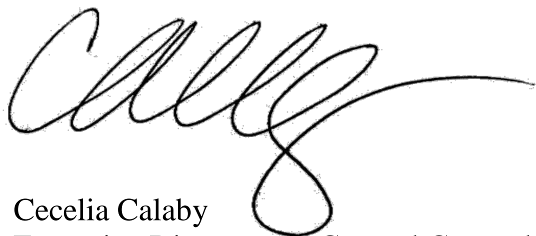
- De Minimis Threshold.
  - For swaps between a U.S. CSE and an emerging market counterparty, the *de minimis* threshold should be set as an aggregate 5% limit on its notional trading volume in uncleared swaps with such counterparties relative to its total notional swap trading volume (cleared and uncleared).
  - For swaps between a Guaranteed non-U.S. CSE and an emerging market counterparty, the *de minimis* threshold should be the same as when the swap is between a U.S. CSE and an emerging market counterparty (as described directly above), except that, instead of limiting the trading volume of the Guaranteed non-U.S. CSE, the limit should apply to the aggregate volume of the uncleared swaps guaranteed by a particular U.S. person.

Cross-border considerations continue to raise complicated issues. It is important that the CFTC seek to address the risks in the swaps market without unduly constraining the global nature of those markets.

We thank the CFTC for the opportunity to comment on this Proposed Rule. We appreciate the efforts of the CFTC to coordinate its rules with the Prudential Regulators and foreign regulators. ABA and ABASA look forward to continuing the work with the parties to finalize and implement these rules. Should you have any questions, we are available to discuss any of these issues in more detail.

Please contact Cecelia Calaby at 202-663-5325 (ccalaby@aba.com) or Jason Shafer at 202-663-5326 (jshafer@aba.com) if you have any questions.

Respectfully Submitted,



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[14] At a minimum, the exclusion should cover any counterparty located in a jurisdiction in which netting, collateral or third party custodial arrangements may not be legally effective, including in the counterparty's insolvency.

cc:

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