ISDA® Safe, Efficient Markets

May 17, 2016

Department of the Treasury/Office of the Comptroller of the Currency
Docket No. OCC-2011-0008/RIN 1557-AD43s

Farm Credit Administration
RIN 3052-AC69

Board of Governors of the Federal Reserve System
Docket No. R-1415/RIN 7100 AD74

Federal Housing Finance Agency
RIN 2590-AA45

Federal Deposit Insurance Corporation
RIN 3064-AE21

Addresses listed in Annex I

Re: LIMITED RELIEF FOR MARGIN REQUIREMENTS FOR NON-CLEARED SWAPS AND SECURITY-BASED SWAPS – NON-NETTING JURISDICTIONS

Ladies and Gentlemen,

The members of the International Swaps and Derivatives Association[1] ("**ISDA**") are in the process of implementing the margin rules for non-cleared swaps and security-based swaps ("**SBS**"). In light of this implementation, ISDA wishes to request relief for margin requirements applicable to counterparties in Non-Netting Jurisdictions (as defined below).

Entities Subject to Margin Rules in Non-Netting Jurisdictions

Request:

If a covered swap entity ("**CSE**") enters into a swap or SBS with a counterparty in a jurisdiction where satisfactory netting opinions cannot be obtained (a "**Non-Netting Jurisdiction**"), the CSE should not be required to post or collect margin to or from that counterparty, subject to a 5% limit on the total amount of swaps with counterparties in

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[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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Non-Netting Jurisdictions ("**Non-Netting Counterparties**"), measured by notional swap amounts.

Discussion:

We assume for purposes of this letter that the CSE is subject to regulation by the Prudential Regulators (the "**PRs**").

Current PR Requirements

The final margin rules issued by the PRs (the "**PR Rules**") provide that, if a netting opinion (or other legal advice supporting netting) cannot be obtained, a CSE must collect gross and post net. Specifically, the PR Rules state that if a CSE cannot conclude after "sufficient legal review with a well-founded basis" that a netting opinion can be obtained, "… the [CSE] must treat the non-cleared swaps and non-cleared [SBS] … on a gross basis for the purposes of calculating and complying with the requirements … to collect margin, but the [CSE] may net those non-cleared swaps and non-cleared [SBS] … for the purposes of calculating and complying with the requirements … to post margin." [2]

This provision causes multiple issues: First, it is not consistent with the requirements in other jurisdictions that have adopted final margin rules and with jurisdictions that have proposed margin rules. Second, swaps and SBS between CSEs and Non-Netting Counterparties are a relatively small percentage of the total market and do not give rise to systemic risk. CSEs are already required to reserve capital against the gross amounts of their exposures and will still continue to do so upon the effective date of the PR Rules. These capital levels will restrict the aggregate amount of activity with Non-Netting Counterparties. Third, practical issues with imposing a gross-posting requirement on Non-Netting Counterparties are likely to result in a dramatic reduction of CSE activity in Non-Netting Jurisdictions until such jurisdictions are able to put legislation supporting the enforceability of netting in place.

Other Jurisdictions with Margin Rules

Two of the largest jurisdictions that have adopted margin rules, the EU and Japan, have established an exemption for swaps with Non-Netting Counterparties. Under the EU margin rules, covered counterparties are exempted from posting margin to Non-Netting Counterparties. If certain additional requirements are met, the covered counterparty is also exempted from collecting margin from the Non-Netting Counterparty.[3] The EU regulators also acknowledge that alternative arrangements, such as posting collateral to international

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[2] 80 FR 74903. Sec. _.5(a)(4).

[3] European Supervisory Authorities "Final 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" ("**Final Draft RTS**"). 8 March 2016. Article 11.

custodians, are not always viable solutions.[4] Under the Japanese margin rules, trades with Non-Netting Counterparties who conduct OTC derivative transactions in the course of trade are fully exempted from margin requirements.[5]

Other jurisdictions that have proposed margin rules have also proposed an exemption. This includes Australia and Hong Kong. In addition, although the Commodity Futures Trading Commission has not yet adopted rules that address Non-Netting Counterparties, it has stated that it "will address commenters' concerns regarding the lack of availability of netting in foreign jurisdictions in its application of the margin rule [in the] cross-border transaction final rule".[6]

Under the PR Rules, for Non-Netting Counterparties, significantly higher levels of margin will be required. As noted by the Australian regulators, a covered entity's posted margin may not be returned in the event of the Non-Netting Counterparty's default "if insolvency laws provide administrators with the power to reject or affirm certain derivative contracts in a manner advantageous to the insolvent counterparty".[7] This places significant liquidity costs and burdens on covered entities and means that margin posted by the covered entity would not be adequately protected.

Low Exposure to Non-Netting Jurisdictions

The EU regulators note that "[i]n order to avoid undermining the objectives of the [margin rules], OTC derivative contracts that are not covered by margin exchange at all should be strictly limited; this can be achieved by setting a maximum ratio between the total notional amount of OTC derivative contracts with counterparties in [Non-Netting Jurisdictions] and the total amount at group level."[8]

While the ratio in the EU Rules has been proposed as 2.5%, there is ongoing advocacy to raise this ratio to 5% on the basis that a 2.5% threshold is not sufficient to allow EU counterparties to continue executing OTC derivative contracts with Non-Netting Counterparties.

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4 Final Draft RTS. Page 7.

5 Arts. 123.10.1(a), 123.11.1(a) of the Cabinet Office Ordinance on Financial Instrument Businesses, etc. (Cabinet Office Ordinance No. 52 of 2007).

6 81 FR 651.

7 Australian Prudential Regulatory Authority Discussion Paper "Margining and risk mitigation for non-centrally cleared derivatives." 25 February 2016. Section 6.3.

8 Final Draft RTS. Page 7.

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Allowing relief from exchanging margin with counterparties located in Non-Netting Jurisdictions will serve to protect CSEs without resulting in a meaningful increase in systemic risk.

Practical Issues

It is not clear how to calculate the total margin required under the PR Rules as described above. For example, questions arise in determining the set of swaps that are subject to the collect gross/post net requirements. Does this set include all swaps or only those swaps that are in-the-money to the CSE? Will the set be the same for both the collection requirement and the posting requirement? If the sets are different for collecting and posting, there will be a mismatch between the way that calculations are made for collecting and for posting. The lack of certainty poses practical problems for CSEs both in terms of maintaining relationships with Non-Netting Counterparties and in terms of making the actual calculations and corresponding transfers. ISDA members request clarification on how to interpret the collect gross/post net requirements.

* * *

Thank you for your consideration, and please contact me if you have any questions.

Sincerely,

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cc: Commodity Futures Trading Commission

ISDA

Annex I

ADDRESSES

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