ISDA® Safe, Efficient Markets

May 15, 2015

Addressees listed in Annex I attached

Basel Committee on Banking Supervision Bank for International Settlements	Department of the Treasury/Office of the Comptroller of the Currency: **Docket No. OCC-2011-0008/RIN 1557-AD43**
International Organization of Securities Commissions	Board of Governors of The Federal Reserve System: **Docket No. R-1415/RIN 7100 AD74**
The European Securities and Markets Authority	Federal Deposit Insurance Corporation: **RIN 3064-AE21**
The European Banking Authority	Federal Housing Finance Agency: **RIN 2590-AA45**
The European Insurance and the Occupational Pensions Authority	Farm Credit Administration: **RIN 3052-AC69**
Commodity Futures Trading Commission: **RIN 3038-AC97**	Securities and Exchange Commission: **RIN 3235-AL12**
Financial Services Agency	

Re: Broad product set for swap margin calculation

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") hereby writes to apprise you that, in making swap margin calculations, ISDA's members may choose to use a

[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

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product set that is broader than the minimum product set required by regulation. ISDA and its members are using the broad product set as part of their implementation of the margin rules, including for purposes of developing models and supporting systems. Absent substituted compliance, we will apply the new margin rules to a set of trades that includes the various definitions of derivatives that apply to each counterparty in its respective jurisdiction.

We will use a broad product set because it is not possible, in the time frames available, to build systems that can determine margin based on a different product set for each party to a swap.

Discussion:

The authorizing statutes for the margin requirements, in both the US and the EU, do not prohibit the use of a broad product set. In the US, the provisions under the Dodd–Frank Wall Street Reform and Consumer Protection Act [2] require the regulators to adopt initial margin ("**IM**") and variation margin ("**VM**") requirements for uncleared swaps and security-based swaps. In the EU, the EMIR provision[3] states that financial counterparties and certain non-financial counterparties must have risk management procedures that require exchange of collateral with respect to OTC derivatives. These provisions are consistent with a product set that includes all products subject to the applicable margin rules and also includes other products as well.

Having a broad product set as an option will allow parties to reduce risk while simplifying the margin process. For example, supervisory guidance encourages US banks to collect and post VM for physically settled foreign exchange ("**FX**") forwards and swaps.[4] For US swap dealers, including such FX swaps and forwards in a broad product set will allow for a single calculation of VM.

Flexibility in choosing a broader product set will greatly facilitate the process of margin collection by allowing each counterparty pair to choose the set that is best suited to the calculation of margin and management of risk for the portfolio of trades between that counterparty pair. This flexibility is completely consistent with the risk-reduction goals of the margin rules because all regulated products would remain subject to the margin requirements. The broad product set available to the parties will therefore potentially include a wide set of bilaterally traded products, even if such products are not swaps or derivatives under the applicable margin rules.

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firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] §4s(e) of the Commodity Exchange Act; and §15F(e) of the Securities Exchange Act.

[3] Art. 11(3) of Regulation (EU) No 648/12 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories ("**EMIR**").

[4] Basel Committee on Banking Supervision, Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions, Feb. 2013.

Differences in Scope. The scope of products subject to the proposed margin requirements is not consistent across the EU, Japan and the US. Among other differences, equity options are outside the scope of the US swap margin rules entirely, although they are subject to both IM and VM requirements under the EU and Japanese proposals. Physically-settled FX swaps and forwards are subject to VM under the EU proposal but not under the US or Japanese proposal. Annex II, attached, shows the product scope of proposed margin rules in the EU, Japan and the US.

For cross border swaps, using different regulatory product sets for the same swap will not be possible as a practical matter. For example, consider a US swap dealer (located in the US) entering into a swap with an EU financial counterparty (that is not a US-registered swap dealer). The US swap dealer will be required to post and collect VM and IM (assuming the relevant thresholds are met) under the US rules.[5] The EU financial counterparty will be required to collect VM and IM from the US counterparty (again assuming the thresholds are met).

For VM, the calculation by the US counterparty will differ from the VM calculation by the EU party because the product set is different. The US counterparty may determine that it is owed VM and the European counterparty may determine that it is also owed VM. Because VM is a single net number based on the overall exposure, and because the two parties are using different product sets, these two determinations cannot be reconciled.

For IM, both the EU and US parties will be required to collect IM and the US party will be required to post IM as well. Because the product sets are different, the IM that must be posted to the EU party will differ under the US and EU parties' respective determinations. Given the complexity and scale of IM calculations for dealers with a significant volume of swaps, it is not feasible, in the time frames available for implementation, for dealers to develop systems that could simultaneously run two sets of IM calculations based on two different product sets. The practical problems are exacerbated by the need to calculate IM on a daily basis.

The inconsistency in the margin product set raises problems in other cross-border situations. For example, if the same dealer is subject to both EU and US margin requirements, then the dealer would need to calculate IM and VM for two different sets of products. (Such dual requirements could arise, for example, for a US branch of an EU bank that is registered as a US swap dealer.) Such dual calculations would encounter the same inconsistency and operational issues discussed above.

These same issues also arise within one jurisdiction if two different sets of margin rules regulations apply. For example, a US entity that is dual registered as a swap dealer and a security-based swap dealer will be subject to the swap margin rules of the CFTC and the

[5] The US dealer would be required to post and collect margin in this situation under the cross-border approach proposed by the Prudential Regulators and two of the three approaches proposed by the Commodity Futures Trading Commission ("**CFTC**"). One of the three of the CFTC's proposed cross-border approaches, the entity-level approach, would give relief from posting IM in this situation if a substituted compliance determination is made.

Securities and Exchange Commission ("**SEC**").[6] Unless such an entity can use a broad product set, it must run two different sets of margin calculations with its counterparties.

If the parties to a swap elect to use a broad product set, then netting will occur within the broad product set to the same extent as permitted for swaps/security-based swaps/OTC derivatives under the swap margin rules. This netting treatment will be similar to the treatment of legacy swaps under the EU and US proposals.

The Broad Product Set Option:

We therefore respectfully advise you that ISDA members will follow the following procedure to determine the product set for margin calculations for a counterparty pair under the applicable margin rules.

For any counterparty pair, the parties may choose to use a broader product set than the set required by either party's applicable regulation. Netting within this broad product set will be permitted to the same extent, and under the same conditions, that would apply to netting of products subject to the margin rules. The broad product set will be used for VM and/or IM and will include derivatives as defined by the rules applicable to each counterparty in its respective jurisdiction.

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ISDA would welcome a chance to discuss this further. Please feel free to contact me at your convenience.

Sincerely,

Mary P. Johannes

Senior Director and Head of ISDA WGMR Initiative

ISDA

[6] The SEC and CFTC recognized the issues of dual-registration in the rule on mixed swaps (CFTC Rule 1.9(b) and Exchange Act Rule 3a68-4.)

Annex I

Addressees

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Secretariat International Organization of Securities Commissions C/ Oquendo 12, 28006 Madrid, SPAIN	Robert deV. Frierson, Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551
The European Securities and Markets Authority CS 60747 103 rue de Grenelle 75345 Paris Cedex 07, France Attention: Steven Maijoor, Chair	Robert E. Feldman, Executive Secretary Federal Deposit Insurance Corporation 550 17th Street, NW Washington, DC 20429
The European Banking Authority Tower 42 (level 18) 25 Old Broad Street London EC2N 1HQ|UK Attention: Andrea Enria, Chairperson	Alfred M. Pollard, General Counsel Federal Housing Finance Agency Constitution Center (OGC Eighth Floor) 400 7th St, SW Washington, DC 20024
The European Insurance and the Occupational Pensions Authority Westhafenplatz 1 60327 Frankfurt am Main Germany Attention: Gabriel Bernardino, Chairman	Barry F. Mardock, Deputy Director Office of Regulatory Policy Farm Credit Administration 1501 Farm Credit Drive McLean, VA 22102-5090
Christopher Kirkpatrick Secretary of the Commission Commodity Futures Trading Commission Three Lafayette Centre, 1155 21st Street NW. Washington, DC 20581	Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, NE Washington, D.C. 20549-1090
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Annex II

DERIVATIVES SUBJECT TO PROPOSED MARGIN RULES

(INITIAL AND VARIATION MARGIN)

Instrument Type	CFTC	Prudential Regulators	EMIR	Japan
Interest Rate	Yes	Yes	Yes	Yes
Foreign Exchange ("FX"), except:	Yes	Yes	Yes	Yes
- FX spot[7]	No	No	No	No
- physically settled FX swaps	No [8]	No [9]	VM, not IM	No [10]
- physically settled FX forwards	No [11]	No [12]	VM, not IM	No [13]
- principal payments on cross-currency swaps	No	No[14]	VM, not IM	VM, not IM
Equity				
- swap based on securities [15]	N/A[16]	Yes	Yes	Yes
- swap based on broad index [17]	Yes	Yes	Yes	Yes
- option based on securities	No	No	Yes	Yes
- option based on broad index	No	No	Yes	Yes
- forward based on securities	No	No	Yes	Yes
- forward based on broad index	No[18]	No[19]	Yes	Yes
Commodities, except:	Yes	Yes	Yes	Yes (not JFSA)[20]

7 US and EU definitions of "spot" are not identical.

8 Supervisory guidelines provide that banks should exchange variation margin for physically settled swaps and forwards.

9 See footnote 8.

10 Currently out of scope from the definition of "OTC Derivatives" under the Financial Instruments and Exchange Act (FIEA).

11 See footnote 8.

12 See footnote 8.

13 See footnote 10.

14 It is not clear under the Prudential Regulators' release whether VM requirements apply to these principal payments.

15 "Securities" for this purpose excludes a broad index. Also, (1) a swap linked to an exempted security (other than a municipal security) is a CFTC-regulated swap; (2) a swap based on a single security with a composite FX feature is a mixed swap and will be subject to CFTC margin rules only to the extent that SEC regulation does not apply.

16 A swap based on securities is a security-based swap and therefore subject to the SEC's jurisdiction rather than the CFTC's jurisdiction.

17 Broad index refers to a product with more than 9 components that satisfies certain other conditions, including weighting requirements (only relevant for US rules).

18 The classification of forwards based on broad indexes is not explicitly addressed in the regulations.

19 The classification of forwards based on broad indexes is not explicitly addressed in the regulations.

20 Currently, commodity derivatives are not subject to the margin rules of the JFSA but may be subject to the margin rules of other regulators.

Instrument Type	CFTC	Prudential Regulators	EMIR	Japan
- physically settled forwards	No	No	Some[21]	**No**
- trade options	Yes	Yes	Some	**No**
Credit				Yes
- based on single name	N/A[22]	Yes	Yes	Yes
- based on index	Yes	Yes	Yes	Yes
Other (e.g. weather)	Yes	Yes	Certain classes only	Yes [23]
Security linked to any asset	No	No	No	**No**

In addition, the following exclusions also apply:

Cleared and Exchanged Traded	CFTC	Prudential Regulators	EMIR [24]	Japan
Derivatives traded on a futures exchange[25]	No	No	No	No
Derivatives cleared on a recognized CCP	No	No	No	No
Derivatives cleared on a unrecognized CCP	**Subject to margin** [26]	**Subject to margin**	No	**Subject to margin** [27]

21 The margin obligation under EMIR will only apply to physically settled commodity contracts if additional conditions are met e.g. that it is traded on a regulated market or MTF.

22 A credit swap based on a single name is a security-based swap and therefore subject to the SEC's jurisdiction rather than the CFTC's.

23 To the extent that the products fall into the definition of "OTC Derivatives" under the FIEA.

24 Even though Article 11(3) EMIR only refers to OTC derivatives, it is expected that the EMIR margin rules will only apply to OTC derivatives not cleared by a CCP (in line with the heading to Article 11) and, on this basis, the margin rules should not apply to OTC derivatives cleared by a CCP even if that CCP is not recognized under EMIR (see ESMA OTC Question 11(j)). However, the margin rules may apply to uncleared derivatives traded on a non-EU futures exchange if that exchange has not been found to be "equivalent" by the European Commission".

25 The definition of swap excludes "any contract of sale of a commodity for future delivery ... [or] securities future product" Commodity Exchange Act §1a(47)(B)(i).

26 Unless the foreign CCP is exempted by the CFTC.

27 Unless the unrecognized CCP is licensed by the JFSA.