

March 7, 2016

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

Robert deV. Frierson, Secretary  
Board of Governors of the Federal Reserve  
System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

Robert E. Feldman, Executive Secretary  
Attention: Comments  
Federal Deposit Insurance Corporation  
550 17th Street, N.W.  
Washington, DC 20429

Alfred M. Pollard, General Counsel  
Attention: Comments/RIN 2590-AA45  
Federal Housing Finance Agency  
Constitution Center (OGC Eighth Floor)  
400 7<sup>th</sup> Street, SW  
Washington, DC 20024

Barry F. Mardock, Deputy Director  
Office of Regulatory Policy  
Farm Credit Administration  
1501 Farm Credit Drive  
McLean, VA 22102

Christopher Kirkpatrick, Secretary  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, DC 20581

**Re: Initial Margin Model Approval Process**

Ladies and Gentlemen:

With reference to the final rules for margin on uncleared swaps<sup>1</sup> (the “**Final Rules**”)<sup>2</sup> under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”), Credit Suisse requests additional guidance from the Prudential Regulators<sup>3</sup> and the Commodity Futures Trading Commission (the “**CFTC**” and, together with the Prudential Regulators, the “**Agencies**”) regarding the process and requirements for obtaining Agency approval of its initial margin (“**IM**”) model. Covered swap entities

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<sup>1</sup> When used in this letter in the context of the Prudential Regulators’ final rules on margin, “uncleared” refers to “non-cleared” and “swaps” refers to swaps and security-based swaps.

<sup>2</sup> This comment letter is submitted with respect to the following final rules: (i) Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008/RIN 1557-AD43, Docket No. R-1415/RIN 7100-AD74, RIN 3064-AE21, RIN 3052-AC69, RIN 2590-AA45, 80 Fed. Reg. 74839 (Nov. 30, 2015) (the “**PR Final Rules**”); and (ii) Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, RIN 3038-AC97, 81 Fed. Reg. 635 (Jan. 6, 2016) (the “**CFTC Final Rules**”).

<sup>3</sup> In this letter, “**Prudential Regulators**” refers to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration.

("CSEs") must comply with the Final Rules, including the IM requirements, as early as September 1, 2016, a date that is rapidly approaching.

Models-based IM calculations estimate the potential future exposure of an uncleared swap more precisely than the standardized schedule method. Accordingly, IM models balance the need to adequately collateralize uncleared swap risk with the efficient use of limited financial resources, promoting both systemic stability and cost-effective hedging for end-users such as pension plans, insurers and producers. In the absence of approved IM models, CSEs must use standardized schedules to calculate IM. Calculating IM by standardized schedules is imprecise and comparatively expensive, and therefore detrimental to market liquidity and the ability of end-users to obtain cost-effective hedging. Therefore, avoiding delays in IM model approvals and ensuring IM models are approved in advance of the applicable IM compliance date are critical.

Credit Suisse is ready to submit its IM models for review and approval, and can do so promptly upon availability of guidance from the Agencies. Our goal is to ensure that our CSEs have approved IM models available by September 1, 2016. However, given that only six months remain until our IM compliance date and such Agency guidance remains unavailable, we are concerned that IM model approvals will not be available, which will have adverse impacts on Credit Suisse, other CSEs, the end-users and the uncleared swaps market generally.

Accordingly, we offer for your consideration our observations and a series of proposals that could mitigate or eliminate the risks arising from delayed IM model approval.

**Adverse Impacts arising from Delays in IM Model Approval:**

*Without timely approval of IM models, CSEs will be required to calculate IM using standardized schedules. Widespread use of standardized schedules will dramatically increase hedging costs for end-users. Uneven and non-uniform approval of IM models across CSEs will create arbitrary "winners" and "losers".*

Prior to publication of the Final Rules, the industry had requested the Agencies to streamline the IM model approval process by permitting CSEs to rely on, as proxies for the Agencies' approval of such CSE's IM model, (i) the Agencies' approval of a common vendor IM model and (ii) approvals by foreign regulators of a CSE's IM model. The Agencies rejected both requests in the Final Rules.

Instead, the Final Rules limit each IM model approval to an individual CSE<sup>4</sup>. The Agencies require each CSE to submit an application, which will undergo a firm-by-firm

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<sup>4</sup> See PR Final Rules at 74876-77 ("Accordingly, while the Agencies expect to coordinate and communicate with foreign regulators regarding covered swap entities that are regulated by both the Agencies and foreign regulators, the final rule requires any quantitative initial margin model to adhere to the standards of the final rule and be approved by the relevant Agency").

review and approval process<sup>5</sup> intended, in the case of the Prudential Regulators, to parallel the bank regulatory capital model approval process.

Together with the possibility of a large number of CSEs<sup>6</sup> potentially requesting IM model approval that could overwhelm the ability of the Agencies to respond in a timely manner, we believe the following aspects of the IM model approval process as set forth in the Final Rules will cause delays:

- IM models must be reviewed and approved on a CSE-by-CSE basis, necessitating individual Agency review and approval of each CSE IM model application.
- A CSE must customize its IM model to the individual firm's "specific uses", including its lines of business and levels of transaction flow<sup>7</sup>, in order to obtain IM model approval, suggesting a high degree of customization of the IM model, a resulting lack of uniformity in the IM model review and approval process and significant interaction with the Agencies.<sup>8</sup>
- A CSE cannot entirely rely on a pre-approved common industry standard model for its IM model. Use of pre-approved vendor components, while permitted, may only marginally reduce the time required for individual, CSE-specific IM model approvals.
- Under the Prudential Regulators' Final Rules, the IM model approval process will be analogous to the capital model approval process.<sup>9</sup> Industry experience with

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<sup>5</sup> See PR Final Rules at 74877 ("To the extent that a covered swap entity uses vendor supplied inputs in conjunction with its own internal inputs and processes, an Agency's model approval decision will apply to the specific initial margin model used by a covered swap entity and not to a generally available vendor supplied model").

<sup>6</sup> The number of provisionally registered swap dealers and major swap participants currently exceeds 100. See [http://www.nfa.futures.org/NFA-swaps-information/SD\\_MSP\\_Registry2.csv](http://www.nfa.futures.org/NFA-swaps-information/SD_MSP_Registry2.csv).

<sup>7</sup> Id. ("Given that covered swap entities may engage in highly specialized business lines with varying degrees of intensity, it is expected that specific initial margin models may vary across covered swap entities. Accordingly, the specific analyses that will be undertaken in the context of any single model review may have to be tailored to the specific uses for which the model is intended").

<sup>8</sup> Further note that the requirement for "CSE-customized" IM models will mean that different CSEs will use different IM models to calculate IM. This will likely cause an increase in the number of collateral disputes between CSEs. The greater the number of collateral disputes, the greater the potential for increased systemic risk, as collateral disputes increase the time between the margin call for and the delivery of the required margin amount.

<sup>9</sup> See PR Final Rules at 74877 ("The nature and scope of initial margin model reviews are expected to be generally similar to reviews that are conducted in the context of other model review processes such as those relating to the approval of internal models for bank regulatory capital purposes").

capital model approvals suggests a highly iterative and potentially lengthy process, which may be completed more slowly by some CSEs as compared to other firms.

A CSE that is subject to IM requirements under the Final Rules prior to receiving IM model approval, including as a result of any delay in its IM model approval, must instead calculate IM using the standardized schedules.<sup>10</sup> Industry estimates predict a substantial disparity between IM costs arising from utilizing IM models versus standardized schedules.<sup>11</sup>

For CSEs, the magnitude of the projected cost disparity suggests that CSEs using standardized schedules will be uncompetitive against CSEs operating with IM model approval. Since the approval process is firm-specific, some CSEs may receive IM model approval later than others. CSEs receiving late approvals will be competitively disadvantaged against peer CSEs receiving earlier approvals, and could be forced out of all or parts of the uncleared swaps market in the interim as trading quickly migrates to the lower cost of approved CSEs. Subsequent IM model approvals may be too late to competitively re-enter the market. These fears are substantiated by the Agencies' own view that they anticipate the IM model will dominate over the standardized IM method.<sup>12</sup>

For the overall market, widespread absence of IM model approval upon commencement of the IM requirement will significantly increase the cost of uncleared swaps in the aggregate beyond current projections. To date, industry projections regarding the economic impact of IM are premised on the assumption that authorization to use IM models will be universally available to all CSEs upon the first IM compliance date.<sup>13</sup>

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<sup>10</sup> See PR Final Rules § 8(a) and CFTC Final Rules § 23.154(a).

<sup>11</sup> See PR Final Rules at 74891 (noting the estimates of the total amount of IM required by U.S. swap entities and their counterparties once margin requirements are fully implemented: ISDA model-based: \$280 billion; BCBS-IOSCO model-based: \$315 billion; ISDA standardized schedules: \$3,570 billion, suggesting a differential between model-based IM and standardized schedule IM of 1,275% to 1,133%).

<sup>12</sup> See PR Final Rules at 74891 (“While it is not possible to forecast with certainty which method will be most widely adopted, there are several reasons to expect a models-based margin methodology to predominate...Accordingly, the Agencies expect the costs of the final rule to be more consistent with the costs associated with the model-based rather than standardized initial margin amounts”).

<sup>13</sup> See ISDA “ISDA SIMM: From Principles to Model Specification” (Jan. 1, 2016) paragraph B (“Background”) (noting the decision to create ISDA SIMM was predicated upon “the realization that the OTC uncleared derivatives market could not operate viably under a schedule-based regime”). See also ISDA “Standard Initial Margin Model for Non-Cleared Derivatives” (Dec. 2013) (“The second BCBS-IOSCO consultation, released in February 2013, presented the results of a quantitative impact study (QIS) that reported an impact of 0.7 trillion EUR with 50mm EUR threshold, using an assumption of model-based derivation of initial margins. Impacts for use of schedule-based margins were not presented, but ISDA estimated over 8 trillion EUR in the case of 50mm EUR thresholds. In particular, over 4 trillion EUR would be demanded of the major dealers (Category A firms) by their clients, an amount that the major dealers would not possibly make available. The industry has concluded that model-based margins are

Implementation of the IM requirement absent concurrent, widespread and uniform IM model approval will result in outcomes significantly worse than currently anticipated. Absence of timely IM model could adversely impact liquidity, reducing availability of cost-effective hedges for end-users such as pension plans, insurers and producers, and curtailing uncleared swaps activity. Such an outcome would be contrary to the Final Rules' goal of enhancing systemic stability of the financial system.

To summarize the concerns raised by the absence of IM model approval by a CSE's IM compliance date:

- Some CSEs may receive IM model approval later than others. Those CSEs will be competitively disadvantaged versus CSEs with IM model approval, resulting in arbitrary and inadvertent “winners” and “losers”.
- Widespread absence of IM model approvals will adversely impact liquidity.

**Recommendations to Avoid Adverse Impacts:**

*We recommend the Agencies either complete all requested IM model approvals ahead of the applicable IM effective date or grant provisional IM model approval to all CSE applicants.*

To avoid the significant risks arising from delays in IM model approvals, we request the Agencies take definitive steps to ensure that CSEs are able to use IM models on their respective IM compliance date. Accordingly, we request the Agencies consider the following recommendations:

- We request the Agencies ensure all CSE-submitted IM models are reviewed and, if appropriate, approved ahead of the applicable IM compliance date (e.g., September 1, 2016).
- Alternatively, in the event individual CSE IM model approvals prior to the applicable IM compliance date is not feasible, we request that the Agencies allow CSEs to rely on provisional IM model approval of the ISDA Standardized IM Model (the “ISDA SIMM”) (without requiring any individual firm review).

Such provisional IM model approval should be made available to all CSEs who have either applied for firm-specific IM model approval or otherwise requested use of the ISDA SIMM, in each case by the later of September 1, 2016 or the applicable IM compliance date. Provisional IM model approval should remain in effect for a CSE until its IM model submission has been approved, subject to the recommendations below.

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feasible, but that the general use of schedule-based margins is not, and that it is essential to the success of this framework that dealers' clients have access to an approved margin model”).

In addition, staggering the effectiveness of approvals of CSE-specific IM models after the IM compliance date based on the date the Agencies approve each CSE's IM model may raise similar arbitrary adverse competitive impacts. Therefore, the Agencies may wish to consider setting a "big bang" compliance date for use of approved firm-specific IM models after the Agencies complete all requested IM models reviews (excluding CSEs substantively their reviews).

For CSEs that have failed their initial IM model review, we request that the Agencies temporarily permit such CSEs to continue to rely on the provisional approval of the ISDA SIMM (possibly with some reasonable IM add-on requirement to ensure such CSEs do not have an advantage over CSEs with IM model approval). Given the novelty of the IM model requirement, such firms should not be penalized by being forced to use the standardized schedules following the "big bang", as it would be catastrophic for such firm's ability to compete in the uncleared swaps market.

Lastly, any IM model approval, whether provisional or otherwise, should be granted sufficiently in advance of the applicable IM compliance date to permit CSEs and their counterparties time to complete necessary contract negotiations and systems implementations.

**Request for Detailed Instructions on IM Model Approval Requirements:**

*We request specific, detailed instructions for the IM model submission and review process as soon as possible so CSEs can submit their applications and receive IM model approval prior to their IM compliance date.*

Timely instructions on the IM model submission and review process can give CSEs sufficient time to prepare IM model approval application, and the Agencies sufficient time to review such applications, to avoid the disruptions arising from the inability to use IM models on the IM compliance date. Continuing absence of such instructions will increasingly jeopardize the chances of timely approval.

Accordingly, we request the Agencies provide instructions to CSEs regarding the IM model submission and approval process as soon as possible. Such instructions should detail matters including but not limited to: (i) the application and submission process, (ii) contacts at the Agencies for inquiries and escalation, (iii) required lead time and expected review times, (iii) specific evidence and documentation requirements, (iv) the method by which applicants can track the approval process, and (v) the means by which approvals are publicized. In the case of the CFTC, such instructions should detail the expedited approval process if the CSE's affiliate has already received (or is in the process of receiving) IM model approval from the Prudential Regulators.

**Request for Global Coordination:**

*We ask that the Agencies coordinate their IM model approval efforts with other global regulators.*

September 1, 2016 is the global compliance date for the IM requirement under the Final Rules, and under similar rules in the European Union, Switzerland, Japan and other major jurisdictions adhering to the BCBS-IOSCO recommendations<sup>14</sup>. For the first time since the financial crisis, major market participants around the world will be bound by a common effective date on arguably one of the most significant rule makings to date, posing a meaningful test on global markets and those who regulate them.

Only six months remain ahead of this date, during which period CSEs and other market participants must come into compliance with the margin rules. Becoming compliant requires planning and methodical, systematic implementation. Necessary tasks include but are not limited to building systems, assessing cross-border intersections and impacts, negotiating amendments and new agreements with counterparties, internal and external testing of operations and systems, and re-shaping businesses to remain competitive and profitable given higher liquidity constraints. Completing these tasks in a methodical, systematic manner that leads to success and avoids wasting of resources requires clear regulatory guidance sufficiently in advance of the compliance date.

To avoid the risk of creating market disruption and imposing potentially crippling burdens on the ability of CSEs to operate and the ability of end users to hedge their risks, we urge the Agencies to take a timely and harmonized approach with fellow regulators adhering to the BCBS-IOSCO recommendations regarding IM model approvals, and take the lead in advocating among them the concerns the recommendations outlined herein.

Credit Suisse appreciates the consideration of these matters by the Prudential Regulators and the CFTC. Please do not hesitate to contact the undersigned at (212) 538-3616 with any questions regarding this letter. We very kindly request a meeting to discuss these issues in greater detail.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'Edward Tsai', written over a horizontal line.

Edward Tsai  
Director  
Credit Suisse

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<sup>14</sup> See Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions (“BCBS-IOSCO”), “Margin requirements for non-centrally cleared derivatives”, September 2013.