24 September, 2015

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TIMING ISSUES FOR MARGIN DELIVERY IN PROPOSED MARGIN REQUIREMENTS FOR UNCLEARED SWAPS

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") is concerned that the proposals on uncleared swap margin issued by the EU and US regulators do not allow sufficient time for the call and collection of initial margin ("**IM**") or variation margin ("**VM**"). We believe that this is an issue of critical importance and that it should be reviewed by the regulators in the Working Group on Margining Requirements ("**WGMR**").

Background: The framework for OTC derivative margin requirements issued by the WGMR (the "**BCBS-IOSCO Framework**") in September 2013 requires the exchange of margin on a daily basis.[2] Regulators in the EU and the US have subsequently issued proposed rules that

[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.

[2] Margin requirements for non-centrally cleared derivatives, Basel Committee on Banking Supervision ("BCBS") and International Organization of Securities Commissions ("IOSCO"), Sep. 2013.

require, with some exceptions, collection of collateral on the business day after the trade date ("**T+1**") for the OTC derivative.[3]

Discussion: We recognize and support the goal of exchanging margin on a daily basis. However, we feel that the approach taken by the regulators in the proposed rules needs to be adjusted in order to facilitate the collection of margin from entities trading across time zones.

There are several key steps to consider in the timing of margin call and settlement: trade, margin calculation, margin call/agreement, and settlement. We set out below the various factors that may impact timing at each stage of the process.

Margin Calculation

- In order for the margin requirement to be calculated, all trading books globally must be closed for the relevant day and the valuations must be completed. For an entity trading globally, this process cannot commence until the close of the US books (because of time zones, the US is last trading area to remain open on any calendar day). As a result, margin will be calculated on T+1.

- For IM, there is an additional level of complexity involved in identification of the trade portfolio. Completion of a level of data reconciliation prior to a margin call will assist in reducing the likelihood of disputes on the basis of differences in the portfolio.

Margin Call/Agreement

- The timing of the agreement to a margin call will depend upon the location of the counterparty's operational processes. For a dealer who closes its books in New York with a counterparty whose operational processes are located in the Asia/Pacific region, a margin call that is calculated on T+1 will be sent on T+2 and is likely to be agreed to on T+2, due to time zone differences. We attach a chart showing the impact of time zone differences on margin call and settlement.

Settlement

- The settlement period for the collateral will depend on the type of collateral. By way of example, cash will settle on the next business day, whereas Japanese government bonds ("**JGBs**") have a settlement cycle of 3 days.

- For IM, it may be possible to reduce settlement times by using a tri-party collateral agent (thereby internalising settlement) but (a) this would increase concentration risk on the big tri-party agents, and (b) smaller counterparties may not be willing or able to use tri-party agents. We understand, based on conversations with tri-party agents, that currently the

[3] EU: Second Consultation paper on the draft regulatory technical standards (the "**Draft RTS**") on risk mitigation techniques for OTC-derivatives contracts, at Chap. 1. Sec. 3, Art. 1 VM and Art. 1 EIM, pp. 31, 32; US: Prudential regulators, proposed rule, Sec. _.3(c) and Sec. _.4(a), at 79 Fed. Reg. 57348 (Sep. 24, 2014) and Commodity Futures Trading Commission ("**CFTC**"), proposed rule, Sec. 23.152(a) and 23.153(a), at 79 Fed. Reg. 59898 (Oct. 3, 2014).

vast majority (over 90%) of the clients of the agents are large brokers. This is due to a variety of reasons including technological and infrastructure requirements and cost. Therefore, the use of tri-party collateral agents may not be optimal for smaller entities that will become subject to the IM requirements during future phases of implementation. Such smaller entities are more likely to utilise a custodian without tri-party capabilities.

- If the margin rules require T+1 delivery of margin, the result will be fragmentation of the market because covered entities subject to margin requirements will not be able to deal with smaller counterparties in other jurisdictions who are not willing to use tri-party collateral agents. Such fragmentation will reduce liquidity and make cross-border hedging more difficult and more expensive.

- Although it will be necessary to include cash as an option for some portion of the IM, it is likely that securities will make up the majority of the IM (partly due to the negative balance sheet impact for custodians of receiving large amounts of cash). That will increase the settlement period for IM.

- Thus, a T+1 collection requirement results in a constraint on the products utilised due to market practice on settlement timings.

The result of the above is that the time period between trade date and settlement date will vary depending upon:

- the global footprint of the netting set of the transactions between the counterparties;

- the jurisdiction of operations of the counterparties;

- the type of asset used as collateral; and

- use of a tri-party custody agent.

Proposal for Timing:

For the reasons discussed above, we propose the following timing requirements.

Margin will be called and collected as soon as it is operationally feasible to do so, within defined time limits. For example, where two counterparties subject to IM are permitted to calculate and call VM up to T+2 (for example, under the proposal below, where Asian counterparties are involved), they may bilaterally agree to calculate and call VM on T+1 or earlier, if feasible, before settling within the standard settlement cycle for their bilaterally agreed eligible collateral asset type.

Our proposed time limits for call and collection of IM and VM are set out below:

1. IM: Calculation and call of IM no later than T+2 (the time after trade is needed for calculation and agreement); and then settlement of IM up to 2 days. Total time between trade and settlement is T+4.

2. VM for firms subject to the IM requirements: Calculation and call of VM on T+1 or T+2 for time zone considerations (if Asian operations are involved). Firms will generally be using cash so settlement can occur within one day. Total time between trade and settlement is T+2 or T+3 (if Asian operations are involved).

3. VM for firms not subject to IM requirements: Calculation and call of VM on T+1 or T+2 for time zone considerations (if Asian operations are involved). These transactions (as opposed to those involving parties subject to the IM requirements) will involve less sophisticated firms with less developed infrastructure. As a result, settlement of VM may require up to 3 days. Total time between trade and settlement is up to T+4 or T+5 (if Asian operations are involved).

Depending upon the factors noted above, the time period between trade date and settlement date could be between T+1 and T+5.

Our proposal allows for flexibility for the variety of factors impacting the call and settlement timelines, without allowing counterparties a longer time period than strictly required within their set of circumstances.

We note that, under our proposal, margin calls and settlement of collateral will be made on a daily basis. As a result, the proposal meets the requirement of the BCBS-IOSCO Framework.

* * *

ISDA appreciates the opportunity to provide these comments.

Sincerely,

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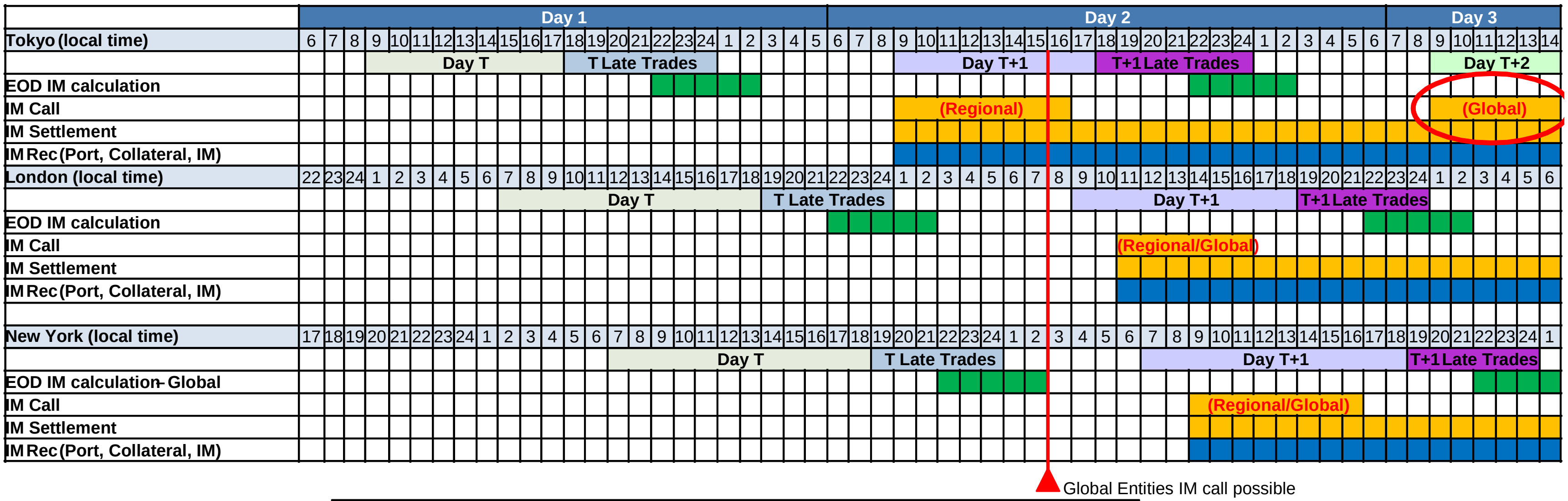
European Insurance and the Occupational Pensions Authority Westhafenplatz 1 60327 Frankfurt am Main Germany Attention: Gabriel Bernardino, Chairman	Legislative and Regulatory Activities Division Office of the Comptroller of the Currency 400 7th St, SW, Suite 3E-218 Mail Stop 9W-11 Washington, D.C. 20219 **Docket No. OCC-2011-0008/RIN 1557-AD43**
Barry F. Mardock, Deputy Director Office of Regulatory Policy Farm Credit Administration 1501 Farm Credit Drive McLean, VA 22102-5090 **RIN 3052-AC69**	Robert deV. Frierson, Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 **Docket No. R-1415/RIN 7100 AD74**
Christopher Kirkpatrick Secretary of the Commission Commodity Futures Trading Commission Three Lafayette Centre, 1155 21st Street NW. Washington, DC 20581 **RIN 3038-AC97**	Robert E. Feldman, Executive Secretary Federal Deposit Insurance Corporation 550 17th Street, NW Washington, DC 20429 **RIN 3064-AE21**
Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, NE Washington, D.C. 20549-1090 **RIN 3235-AL12**	Alfred M. Pollard, General Counsel Federal Housing Finance Agency Constitution Center (OGC Eighth Floor) 400 7th St, SW Washington, DC 20024 **RIN 2590-AA45**

The following illustrates a potential daily IM calculation and exchange proposal



Process

1. Calculate IM daily*
   - Late trades to be included in next days margin call
2. Call agreed amount T+1 regionally and T+2 globally (settlement occurs per industry standards)
   - If calculation amounts differ, settle lower of the two amounts
3. Perform portfolio and IM rec
4. Dispute Resolution for non -agreed margin amounts
5. Resolve dispute and settle remainder of call

* Assumes use of Regional Market Data