ISDA® Safe, Efficient Markets

July 8, 2016

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
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Secretariat
International Organization of Securities Commissions
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REQUEST FOR UNIFORMITY IN TIME FRAME FOR OTC DERIVATIVE MARGIN REQUIREMENTS

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") requests the Working Group on Margining Requirements (the "**WGMR**") to re-set the phase-in of the OTC derivative margin requirements so that there is a uniform time frame for adopting the margin rules in all major financial jurisdictions. This request is made in light of the recent statement by the European Commission of its intention to delay implementation of derivative margin requirements for the firms that were previously scheduled to comply with the requirements starting on September 1, 2016.

Because our members are currently devoting significant resources to the margin requirements, and because the initial deadline in many jurisdictions of September 1, 2016 is fast approaching, we would greatly appreciate a prompt response to this letter.

Request:

ISDA requests that the WGMR re-set the phase-in timeline for both variation margin ("**VM**") and initial margin ("**IM**") requirements so that the margin rules take effect at a uniform time in all major financial jurisdictions, and at a time that is no earlier than the new implementation dates applicable under the final EU margin rules. To demonstrate readiness for compliance with margin rules, firms scheduled to comply with the requirements starting on September 1, 2016 ("**Phase I Firms**") would

[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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obtain IM model approvals, and make, exchange and agree to IM calculations starting on September 1, 2016. Phase I Firms would provide this IM data to their respective regulators upon request.

However, no firms would be required to transfer IM before the applicable implementation dates under the EU margin rules.

Discussion:

There is now a discrepancy in implementation timing between the margin rules of jurisdictions that continue to apply a September 1, 2016 implementation date ("**Subject Jurisdictions**"), which include the US, Japan and Canada,[2] and jurisdictions that do not have a September 1, 2016 margin rule implementation date ("**Delayed Jurisdictions**"), which include the EU, Switzerland, Singapore, Hong Kong and Australia.[3] Because of this discrepancy, the market will face numerous obstacles, including market dislocation, disruption of cross-border trading, concentration of counterparty risk, new implementation challenges and an unlevel playing field for firms in Subject Jurisdictions. These disruptions will have a significant impact on markets and firms. The discrepancy in timing is also inconsistent with the cross-border harmonization that has been a guiding principle of the BCBS/IOSCO Framework.[4]

1. Market Dislocation, Disruption of Cross-Border Trading, Concentration of Counterparty Risk

The divergence in margin requirement implementation dates will cause fragmentation in the market and a reduction in liquidity. Certain Phase I Firms ("**Subject Entities**") in Subject Jurisdictions will remain subject to their jurisdictions' margin rules even if they face counterparties in Delayed Jurisdictions. Other firms ("**Delayed Entities**") will not be subject to any margin rules because of delayed implementation timing in the Delayed Jurisdictions. Delayed Entities will include, for example, non-US swap dealers (without a US guarantee or a US parent) facing EU counterparties.

Delayed Entities will be strongly incentivized to trade with other Delayed Entities, rather than with Subject Entities, in order to avoid the costs of margin rules. For example, the costs to Delayed Entities of trading with US Subject Entities are illustrated in the scenarios set out in Appendix I, based on a 12 month cost basis. In these examples, the additional cost to a Delayed Entity of trading with a US Subject Entity, rather than with another Delayed Entity, range as high as more than twice a typical bid/offer spread. Similar costs would apply to Delayed Entities trading with other non-US Subject Entities.

2 As of the date of this letter, none of these jurisdictions has delayed its September 1, 2016 deadlines.

3 Singapore, Hong Kong and Australia have not yet finalized their OTC derivative margin rules and there will now be insufficient time for Phase I Firms to implement them by September, 1 2016. The Swiss regulator has indicated that it intends to align the timing of the Swiss margin rules with the EU implementation timeline.

4 *See* the margin framework for non-centrally cleared derivatives issued by the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**") in March 2015 at http://www.bis.org/bcbs/publ/d317.pdf (the "**BCBS/IOSCO Framework**").

These same pricing pressures could encourage a Subject Entity that has an affiliate that is a Delayed Entity to shift its trading volume to the affiliated Delayed Entity, leading to strains on the market resulting from a shift in trading volume. It is likely that separate markets will develop – one for Subject Jurisdictions, and one for Delayed Jurisdictions. This scenario will result in market fragmentation with two distinct liquidity pools and increased risk concentration within each market, transferring costs to market participants including end-users.

Any delays by the EU (or by other Delayed Jurisdictions) of VM requirements originally set to take effect after September 1, 2016 (such as the March 1, 2017 VM requirements) will result in further market fragmentation and reductions in liquidity for client-facing swaps because Subject Entities, but not Delayed Entities, will be required to collect VM from clients. Lack of synchronization will mean that, at every stage, counterparties in Delayed Jurisdictions will prefer to trade with Delayed Entities rather than with Subject Entities and, as a result, a tiered market will develop.

2. New Implementation Challenges

The timing discrepancy between the margin rules of different jurisdictions will result in new implementation challenges due to uncertainty about the final margin requirements in Delayed Jurisdictions at the time the requirements in Subject Jurisdictions must be implemented as well as due to the complexity of having to modify systems and documents to comply with regulations at least twice (first with respect to the Subject Jurisdictions' margin rules and then again with respect to other margin rules).

Final Margin Rules Uncertain. The final text of the margin rules in Delayed Jurisdictions is not yet certain. Firms will need to ensure that their models and trading systems are up and running in order to meet the timeline of Subject Jurisdictions, while trying to accommodate future adjustments based on the margin rules of Delayed Jurisdictions without knowing what their final content will be. Systems that will need to be able to handle multiple cross-border trades and multi-jurisdiction compliance at a highly intricate level will need to be running and fully functional well before essential inputs from major jurisdictions are available.

New Complexity for September 2016, Additional Adjustments in 2017. Because of the EU delay, systems for Subject Entities will now need to be adjusted at least twice: first to remove inputs required by the EU margin rules that were built in before the EU announced its delay, and again later to incorporate the final EU margin rules (the content of which is currently uncertain). Potentially, additional adjustments will be needed if other Delayed Jurisdictions adopt final margin rules on other dates. These repeated adjustments will be extremely disruptive for affected firms at many levels, including compliance, modeling, operations, documentation, negotiation, portfolio reconciliation and dispute resolution. With each adjustment, tests will have to be run to check for robustness at each stage. The requested relief will spare firms the costs of at least one extra implementation round.

Additional Documentation Requirement. Similar uncertainty and increased complexity will apply to the documentation process. The documentation executed for Subject Entities in September will subsequently need to be amended to meet EU requirements when the EU margin rules become final. If other Delayed Jurisdictions use different phase-in dates from those used by the EU, then yet another set of amendments will be required. As a result, Subject Entities will need to go through extra sets of amendments for all applicable documentation. To the extent there are conflicts between the final EU margin rules (or the final margin rules of other Delayed Jurisdictions) and the final margin rules of Subject Jurisdictions, such inconsistencies will have to be addressed.

Additional Netting Sets. Differences in timing between implementation dates will also lead to multiple netting sets, further complicating the task of collecting and monitoring margin. For example, if the US Prudential Regulators ("**PR**") IM rules take effect starting on September 1, 2016, and the EU IM rules take effect starting on June 1, 2017, then for a counterparty pair subject to the US PR and EU margin rules, the netting set for IM for swaps entered into between September 1, 2016 and June 1, 2017 is likely to be a different set than the one for swaps entered into after June 1, 2017 because these pre-June 1, 2017 swaps would otherwise become subject to EU IM requirements. The result is potentially three netting sets: one for swaps executed before September 1, 2016, one for swaps executed between September 1, 2016 and June 1, 2017 (subject to the US PR margin rules but not EU margin rules), and a third for swaps executed after June 1, 2017 (subject to both the US PR margin rules and the EU margin rules). Additional netting sets may be required if other Delayed Jurisdictions use different phase-in dates from those used by the EU.

3. Level Playing Field

The market will respond to the lack of uniformity in margin requirement implementation timing by seeking out the most cost-effective trades. It will become more cost-effective for firms in Delayed Jurisdictions to trade with counterparties that are Delayed Entities rather than to trade with counterparties that are Subject Entities due to the discrepancies in margin amounts required to be transferred. In addition, Subject Entities will face significant rises in costs overall due to the increased complexity caused by the differing implementation dates, as discussed above, while Delayed Entities will not face similar cost increases. Delayed Entities will be able to price transactions at lower rates than their Subject Entity competitors, resulting in the market fragmentation mentioned previously. As a result, Subject Entities will face a significant competitive disadvantage relative to Delayed Entities.

4. Global Harmonization

A key principle of the BCBS/IOSCO Framework is that "[r]egulators should undertake a coordinated review of the margin standards once the requirements are in place and functioning to assess the overall efficacy of the standards and to ensure harmonisation across national jurisdictions as well as across related regulatory initiatives."[5]

Cross-border harmonization will be significantly reduced if Delayed Jurisdictions and Subject Jurisdictions use different implementation dates. The WGMR process has produced margin rules that are largely consistent across major jurisdictions, including with respect to timing, and granting our request will help preserve this consistency.

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5 BCBS/IOSCO Framework p. 5.

Conclusion:

Timing discrepancies will result in market dislocation, disruption of cross-border trading, concentration of counterparty risk, new implementation challenges, and severe reduction in the ability of Subject Entities to compete in the global market. ISDA makes this request to mitigate the negative effects of the timing discrepancy caused by the EU delay and the delay in implementation of margin requirements in other Delayed Jurisdictions, and to allow for a more robust and efficient margin implementation process that will benefit the global markets in the long term.

It is critical that ISDA members know as soon as possible whether our request will be considered, so we would appreciate a swift response.

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

Sincerely,

Scott O'Malia
Chief Executive Officer
International Swaps and Derivatives Association, Inc.

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Appendix I

<u>GLOBAL MARGIN RULES FOR UNCLEARED DERIVATIVES</u>

Cost Impact – The Small Picture

Trade Example 1: 7yr USD Zero-Coupon CPI Inflation Swap		Trade Example 2: 10yr EUR Fixed-Floating Swap		Trade Example 3: Sell 4y CDX HY Index	
Trade Size	$10mm	Trade Size	$10mm	Trade Size	$10mm
DV01	$6,800/bp	DV01	$7,500/bp	DV01	n/a
Transaction Cost*	1bp	Transaction Cost*	0.25bp	Transaction Cost*	.125 points
SIMM IM	$217,000	SIMM IM	$240,000	SIMM IM	$740,000
Annual IM Cost**	$4,340	Annual IM Cost**	$4,800	Annual IM Cost**	$14,800
Annual IM Cost in bps	0.74	Annual IM Cost in bps	0.64	Annual IM Cost in points	0.15
SIMM/Transaction Cost	64%	SIMM/Transaction Cost	256%	Annual SIMM/Transaction Cost	120%

* (Offer – Bid)/2

** Assuming 2% cost of funds

- In Example 1, the cost to a European bank of trading with a US bank is 64% higher vs. trading with another European bank
- In Example 2, the cost is 256% higher
- In Example 3, the cost is 120% higher
- The longer the inconsistency in rules remains, the larger this problem becomes