September 30, 2019

Dear Mr. Pearson,
Dear Mr. Planta,
Dear Mrs. Vaillant,
Dear Dr. Zweimüller,

Eligibility of non-EU Money Market Funds (“MMFs”) as Initial Margin of non-cleared derivatives – Request for modification of the EMIR Margin RTS

With the upcoming revision of the European Commission Delegated Regulation (EU) 2016/2251 (EMIR Margin RTS) in the context of the EMIR Refit framework, the European Supervisory Authorities will notably adjust the timeline of implementation of IM for non-cleared derivatives as a follow-up to the BCBS IOSCO statement from 23rd of July 2019 that split between a phase V (for firms with AANA between €750bn and €50bn, which will have to apply initial margin by 1st of September 2020) and a phase VI (for firms with AANA between €50bn and €8bn, which will have to apply initial margin by 1st of September 2021). One of the main reasons for this adjustment is that the scope of entities covered by phases V and VI is not only much larger than the scope of entities covered by phase I to IV but also structurally different as many asset managers will now be concerned.

This new environment of in scope entities makes it appropriate to consider alternative forms of collateral as compared to previous phases. It would be appropriate to expand the scope of eligible instruments beyond EU UCITS and more specifically to non-EU Money Market Funds (MMFs).
The International Swaps and Derivatives Association (“ISDA”) requests that the ESAs extend the scope of MMFs for use as initial margin to additional funds beyond UCITS, and extend the applicability of the existing equivalence determination in respect of the US Commodity Futures Trading Commission’s (“CFTC”) Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Final Rule (“CFTC Rules”).

Both in the United States and European Union, the regulatory requirements for the margining of non-cleared derivatives allow for the use of MMFs as collateral. However, each regulatory regime imposes restrictions that, in practice, mean that there are no MMFs that are eligible under both the EMIR Margin RTS and either the CFTC Rules or the Margin and Capital Requirements for Covered Swap Entities adopted by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (“USPR Rules”). As a result when an entity in scope of the CFTC Rules or USPR Rules (the “US margin rules”), faces an entity in scope under the EU regulatory regime, neither counterparty may post cash to be reinvested into an MMF nor directly post an MMF as collateral. Where substituted compliance is available, the conditions on use of substituted compliance mean that, depending on the location of the parties, either US or EU MMFs can be posted, but not both. This restriction significantly decreases the options for viable eligible collateral considering settlement and transfer timing limitations and global fragmentation.

**Background: Industry’s Use of Cash and MMFs as Collateral**

Cash is widely used as collateral in the derivatives market. According to the latest ISDA Margin Survey¹, 75.3% of derivatives collateral posted is cash. Cash settlement processing is efficient, fungible, and a high quality and liquid asset. Cash is often then swept into a MMF to reduce custodian risk.

Posting cash is a necessity for entities both directly and indirectly subject to the IM requirements.

1) Firms may not have ready access to eligible non-cash collateral.
2) Firms may not have the operational infrastructure and/or the capacity to efficiently transform cash to eligible collateral.
3) Transformation outside the custodian can be costly for firms with less scale.
4) Holding securities specifically in anticipation of collateral calls creates a drag on performance and decreases investment performance for end investors.
5) There are situations where transformation is not possible or practical prior to posting e.g. due to reinvestment/custodian cut-off times.

For both voluntary and also mandatory IM, buy side market participants have steadily increased the use of third party IM segregation arrangements and to effectively meet regulatory required margin settlements deadlines, and as a consequence, there has been an increased use of MMFs as a secure and efficient reinvestment option with cash margin.

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**Broaden eligible MMFs beyond UCITS**

In order for pledgers to meet their and their counterparty’s regulatory obligations, eligible collateral may need to meet multiple regulatory regimes’ requirements. For example, when an EU entity that is a financial counterparty (FC) or non-financial counterparty above the clearing threshold (NFC+) trades with a US swap dealer (“SD”) that would be an FC if it were established in the EU, the US and EU rules will apply (subject to substituted compliance). The EU party may post cash and then reinvest that cash into a MMF that meets the US eligible collateral requirements for MMFs, per the US rules that requires cash initial margin to be reinvested into another form of eligible collateral. The EU eligible collateral requirements will also apply to that posting and reinvestment.

Based on the current EU requirements, only MMFs that are UCITS may be posted as eligible collateral – no other structure of MMF. However, under the US margin rules, MMFs that are UCITS do not qualify as eligible collateral due to their ability to use repo. As a result, in the example above, the EU pledging counterparty would not be allowed to post cash for reinvestment into a MMF (subject to the availability of substituted compliance, discussed further below). Please note: ISDA has submitted a request to the CFTC and US Prudential Regulators to allow repo, reverse repo, and securities lending within MMFs used as initial margin.²

To accommodate a global market, MMFs in additional structures to UCITS must be available. We request that the requirements regarding MMFs as eligible collateral be expanded to include issuing entities that have similar MMF regulatory oversight within their applicable regime. To date, ISDA members have mostly identified the issue in the context of EU-US contractual relationships. But naturally such extension of eligible MMFs should be based on equivalence determination conditions, irrespective of the concerned jurisdiction.

ISDA appreciates that the upcoming revision of the EMIR margin RTS, based on the mandate given the three ESAs by the EMIR Refit regulation, should primarily address:

- a) VM carve-out for FX swaps and FX forwards;
- b) adjustment to the IM implementation phase-in for non-cleared derivative after the BCBS/ IOSCO statement published on 23rd of July 2019;
- c) extension of the intragroup derogation;
- d) extension of the Equity options derogation.

ISDA members however feel that it would make sense for the ESAs to use the opportunity given to revise the RTS to add non-EU collective investment undertakings to the list of eligible collateral.

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² Joint Trade Association Letter to CFTC and US Prudential Regulators regarding Cash and MMFs as Initial Margin
ISDA considers that the most simple and effective way to achieve this is to amend article 4(1) of the margin RTS to include shares or units in Money Market Funds authorised in accordance with the EU Money Market Funds Regulation (Regulation (EU) 2017/1131) and non-EU collective investment undertakings that are subject to equivalent supervision to that set out in the Money Market Funds Regulation.

We then propose the following amendment to the EMIR Margin RTS:

**Article 4**

**Eligible collateral**

1. A counterparty shall only collect collateral from the following asset classes:

   
   (s) (new) shares or units in money market funds authorised in accordance with Regulation (EU) n°2017/1131 and non-EU collective investment undertakings that are subject to equivalent supervision to that set out in the Regulation (EU) n°2017/1131.

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**Expand and Issue Equivalence Determinations for US Margin Rules**

In October 2017, an Equivalence Determination relating to the CFTC Rules was published with the intention, as stated in paragraph (1), to “avoid the application of duplicative or conflicting rules and therefore contributes to the achievement of the overarching aim of Regulation (EU) No 648/2012 to reduce systemic risk and increase transparency of derivatives markets by ensuring an internationally consistent application of principals agreed with the Union’s international partners and laid down in that Regulation.”

ISDA appreciates the intention of the Equivalence Determination to reduce global friction between counterparties that must meet multiple regulatory regimes’ requirements. Being able to use principal-based guidelines along with home country regulation can ease the operational burden and maintain a global trading environment.

However, there are some limitations that make the Equivalence Determination difficult to use. For example, in paragraph (7), it specifically states: “The operational risk mitigation techniques for OTC derivative contracts not cleared by a CCP, as added in a new section 4s(i) to the CEA by section 731 of the Dodd-Frank Act, apply to swap dealers and major swap participants, as defined in the CEA. This Decision should therefore cover the legal, supervisory and enforcement arrangements regarding timely confirmation, portfolio compression and reconciliation, valuation and dispute resolution obligations, as well as margin requirements applicable to swap dealers and major swap participants established in the USA that are authorised and supervised in accordance with the CFTC Regulations.”

Similar to the need to expand the money market fund structures allowed beyond UCITS, in order to maintain a global trading environment, the Equivalence Determination should not be limited to cases where the CFTC-registered entity is established in the US. For this purpose, ISDA requests that the European Commission uses its powers under article 13(2) of EMIR to amend

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3 COMMISSION IMPLEMENTING DECISION (EU) 2017/1857 of 13 October 2017
implementing decision 2017/1857 to remove the requirement that the CFTC-registered counterparty is established in the US.

ISDA also requests that the ESAs issue an equivalence determination with respect to the USPR Rules for the benefit of SDs and security based swap dealers (“SDSD”), regardless of whether the registered entity is established in the US. This will allow a more robust and consistent method for managing equivalence determination applicability with reduced market fragmentation. Naturally, the equivalence determination should recognise not only cases where a US-incorporated firm subject to the USPR Rules faces an EU counterparty but also the cases where an EU-incorporated firm subject to the USPR Rules faces a US counterparty.

Summary

Accordingly, for the preceding reasons indicated, ISDA requests that EU regulators:

- amend the EU Margin RTS to allow for the broader range of money market funds, not to be limited to UCITS;
- amend the Equivalence Determination in respect of the CFTC Rules to include SDs not established in the US; and
- issue an equivalence determination in respect of the USPR Rules for the benefit of SDs and SBSDs regardless of whether the registered entity is established in the US.

Thank you for your consideration of this important matter.

Tara Kruse
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International Swaps and Derivatives Association