18 August 2014

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, SWITZERLAND
Sent by email to: baselcommittee@bis.org

Secretariat
International Organization of Securities Commissions
C/ Oquendo 12, 28006 Madrid, SPAIN
Sent by email to: wgmr@iosco.org

Re: Timing issues for margin rules for uncleared derivatives

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") is concerned about the timing of the implementation of the margin rules for uncleared swaps as proposed by the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**") in September 2013[2]; by the European regulators in April 2014[3]; and by the Japanese Financial Services Agency in July 2014[4]. We expect the US regulators to issue a similar proposal in a few months. In particular, because of the implementation issues raised by the proposals, the duration of the rule–making process and the challenges of meeting the margin rules, ISDA submits that the market will not be able to meet an implementation date of

[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", September 2013.

[3] Consultation Paper on the Draft regulatory technical standards (the "**Draft RTS**") on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Art. 11(15) of Regulation (EU) No 648/2012 published by the European Securities and Markets Authority ("**ESMA**"), the European Banking Authority ("**EBA**") and the European Insurance and the Occupational Pensions Authority ("**EIOPA**", and together with ESMA and EBA, the European Supervisory Authorities, the "**ESAs**") on 14 April 2014.

[4] Publication of draft amendments to the "Cabinet Office Ordinance on Financial Instruments Business" and "Comprehensive Guidelines for Supervision" with regard to margin requirements for non-centrally cleared derivatives, on 3 July 2014.

December 2015 and therefore suggests that the implementation date be delayed and that the requirements for variation margin ("**VM**") be phased in over time.

A. Timing for implementation should be delayed.

The proposed effective date of December 2015 is simply too early. Implementation has been delayed because of significant issues in the proposed rules, including a lack of clarity and a potential increase in risks. Implementation efforts will continue to be constrained until the rules have been finalized, which does not appear likely to occur until early to mid-2015. After the rules are clarified and finalized, a significant period of time will be needed to put the margin arrangements in place: we request a period of two years after the rules are clarified and finalized in all of the Europe, Japan and the US.

Implementation issues: The relevant issues are described in the letter sent by ISDA to the ESAs in July 2014[5] and in a follow-up analysis of the currency mismatch haircut (the "**FX Haircut**") that will be sent by ISDA to the ESAs in August 2014. These issues include a lack of clarity for some proposals, which makes it difficult for participants to apply the rules, and potential increases in risk, for which further discussion with the regulators is appropriate. One example is the FX Haircut: this proposed haircut would impose additional risk on the market and it is unclear how it would be implemented. A second example is the concentration limits proposed by the ESAs which: were not reflected in the BCBS-IOSCO September proposal; potentially increase risk in certain contexts (such as equity derivatives); and would pose significant operational complexity. A third example is the scope of the ESAs' proposal and, in particular, the absence of an exemption for NFC-s[6] outside the European Union ("**EU**"): this proposal is not consistent with the BCBS-IOSCO proposal and would have a significant adverse effect on the ability of EU firms to trade with non-EU corporates. Because of implementation issues such as these, market participants have not been able to develop systems, prepare clients, or draft complete documentation for the margin requirements. As a result, although market participants and ISDA have devoted significant resources to anticipating the margin requirements, they have not been able to undertake much of the detailed and time-consuming implementation work and will not be able to do so until these issues are addressed.

Duration of rule-making process: Uncertainty in the market will remain until the margin rules are finalized and participants know that further changes are unlikely and this uncertainty delays implementation. Timing of final rules is therefore important and it appears increasingly likely that the rules in the EU and the US will not be finalized until early to mid-2015 and in Japan until approximately the same time or slightly earlier.

Two year period: We estimate that market participants will need a minimum of two years from the time when rules are clarified and finalized to the effective date. ISDA discussed the operational issues involved in the implementation of margin requirements in its prior letter to

[5] ISDA and the Securities Industry and Financial Markets Association ("**SIFMA**") letter re: Consultation paper regarding draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP, dated 14 July 2014.

[6] See definition of "NFC-" in the 14 July ISDA/SIFMA letter (and for purposes of this letter the definition includes a non-EU entity that would be an NFC- if established in the EU.)

BCBS and IOSCO.[7] One issue of particular importance is cross-border harmonization. Due to the global nature of the margin requirements, market participants will need to ensure that new documentation, models and technological and other operations are compliant with the requirements set forth by all regulators. Harmonization has particular urgency in the case of mandatory two-way margining because cross-jurisdiction swaps will involve the margin rules of two jurisdictions. As opposed to margin, other supervisory requirements (such as capital rules) can be imposed on all institutions within the jurisdiction of a particular regulator. However, the two-way nature of the VM and initial margin ("**IM**") requirements makes such a localized approach unworkable for cross-jurisdictional trades unless there is close harmonization between the jurisdictions.

B. Include a phase-in for VM.

We renew our request for a phase-in for VM. As discussed in our July 14 letter to the ESAs, many parties do not currently post VM and implementation of the VM requirements as proposed in the Draft RTS will require fundamental changes to existing VM arrangements. A "big bang" approach under which all market participants must be fully compliant with the VM rules as of a single compliance date is unnecessary and potentially systemically dangerous. It is unnecessary because many of the parties required to post VM will be trading in low volumes and will pose very little risk to the system. A big bang approach is potentially systemically dangerous because of the difficulties of implementing the VM requirements simultaneously for a very large population of swap users.

In addition, the likely result of imposing VM requirements on smaller market participants is that they would be forced out of the market because they are not able to meet VM operational and documentation requirements. A mechanism needs to be established to permit non-systemic market participants to remain in the derivatives market.

We request the following: phase in VM with zero thresholds corresponding to the IM phase-in, except with an expedited schedule for VM: start the threshold level at EUR 3 trillion and decrease it to 2.25 trillion, 1.5 trillion, 0.75 trillion, 8 billion in two month increments beginning on the date of implementation. Under such an approach, all market participants of systemic importance would eventually post VM while non-systemic market participants (those with less than EUR 8 billion in aggregate notional) would not need to post.

C. Do not impose implementation dates at the time of the "code freeze" or at year-end

We suggest that the implementation dates should not fall in December or January or, for Japanese firms, at the end of March. Financial institutions generally prohibit technological changes to their systems between early December and mid-January in an annual code freeze. This practice is consistent with principles of prudential bank management and long-standing best practice across the industry, and was established in conjunction with the bank supervisory process. In addition, financial institutions are generally going through year-end book-closing

[7] ISDA letter Re: Second Consultative Document: "Margin Requirements For Non-Centrally-Cleared Derivatives", dated March 18, 2013. Available at: http://www2.isda.org/attachment/NTQwMg==/ISDA%20Response%20to%20BCBS%20242.pdf

processes in December or January and, in Japan, at the end of March. Implementing any new procedures that will require systems changes is extremely difficult during the code freeze or at year-end.

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ISDA appreciates the opportunity to provide this letter to BCBS and IOSCO. We would welcome a chance to discuss this further. Please feel free to contact me or my staff at your convenience.

Stephen O'Connor
Chairman
ISDA