

January 4, 2017

Accounting Group – Interpretations
Office of the Chief Accountant
United States Securities and Exchange Commission
100 F. Street N.E.
Washington, D.C. 20549

Attention: Brian Staniszewski

Confirmation Letter Related to ISDA¹ Accounting Committee Whitepaper ‘Accounting Impacts of CCPs’ Rulebook Changes to Financial Institutions and Corporates May 2016’ and subsequent submissions.

This is to confirm our discussion on November 30, 2016 with the Staff of Office of the Chief Accountant of the Securities and Exchange Commission (the “Staff”) regarding an accounting submission with the title ‘Accounting Impact of CCPs’ Rulebook Changes to Financial Institutions and Corporates May 2016’ (the “Submission”) and related follow up submissions. We understand that the Staff’s conclusions are based solely on the facts and circumstances provided to the Staff via: (a) Submission dated May 27, 2016; (b) supplemental submissions provided on September 16, 2016 and October 20, 2016; and (c) conference calls held on June 15, 2016, July 13, 2016, and August 3, 2016.

Background

Each of the Chicago Mercantile Exchange (“CME”) and LCH.Clearnet Limited (“LCH”) (collectively, the CCPs) have made amendments to their respective rulebooks which result in the legal characterization of variation margin payments for certain derivative contracts, referred to as settled-to-market (or “STM”) in the Submission, being altered to constitute settlement of the derivative’s mark-to-market exposure and not collateral. CME recently made changes to their rulebook addressing the treatment of variation margin on trades cleared through the CME and those changes became effective on January 3, 2017. More background information is contained in the Submission.

Confirmation of Conclusions Discussed

Based on the November 30, 2016 discussion, we understand that the Staff does not object to the conclusions of the ISDA Accounting Committee outlined in the submissions, that:

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 66 countries. These members comprise a broad range of 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, such as exchanges, intermediaries, clearing houses 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 website: www.isda.org.

1. The changes to the rulebooks of LCH and CME, as supported by legal opinions from external counsel, should result in the presentation of variation margin amounts as settlement of the derivative exposure² and not collateral against it because the timing, amount, and uncertainty of cash flows related to the STM derivative contract is considered a single unit-of-account for purposes of applying the accounting and presentation guidance in ASC 815.
2. The derivative disclosure requirements in ASC 815 would continue to apply for STM derivative contracts given that STM derivative contracts remain term instruments and that daily settlement of the derivative exposure does not change or reset the contractual terms of the instrument. Such disclosures would be applicable over the remaining term of the STM derivative contract.
3. The disclosure requirements in 815-10-50-4B(b), regarding cash collateral disclosures, should not be applied to variation margin amounts for the STM derivative contracts.
4. The de-designation and re-designation of existing hedging relationships under ASC 815 would not be required solely because of the amendment described in the Submission to the respective CME and LCH rulebooks.
5. The daily settlement of the derivative exposure through daily payment or receipt of variation margin amounts for the STM derivative contracts described in the Submission would not require a daily de-designation and re-designation of hedging relationships under ASC 815.
6. The inclusion of price alignment amount and variation margin in the single unit-of-account with the derivative exposure would not prohibit application of the “short-cut method” under ASC 815.

Any changes other than the inclusion of price alignment amount payments and daily settlements for STM derivative contracts, however, would need to be evaluated under the criteria in ASC 815 for purposes of applying short-cut method.

We note that the Staff’s views are based on the facts and circumstances specified in the Submission and should not be applied to other facts and circumstances. Any changes other than inclusion of price alignment amount payments and daily settlements for STM derivative contracts (as described in the Submission) would be subject to evaluation under the requirements in ASC 815.

Sincerely,



Daniel Palomaki
Citigroup
Chair, N.A. Accounting Policy Committee

² As in the Submission, throughout this letter, the term ‘derivative exposure’ is intended to mean the derivative net present value as calculated by the CCP.