ISDA®

International Swaps and Derivatives Association, Inc.
360 Madison Avenue, 16th Floor
New York, NY 10017
United States of America
Telephone: 1 (212) 901-6000
Facsimile: 1 (212) 901-6001
email: isda@isda.org
website: www.isda.org

February 11, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: RIN 3038-AC98 - Notice of Proposed Rulemaking regarding General Regulations and Derivatives Clearing Organizations

Dear Mr. Stawick:

The International Swaps and Derivatives Association, Inc. ("ISDA") submits these comments in response to the Notice of Proposed Rulemaking on General Regulations and Derivatives Clearing Organizations in which the Commodity Futures Trading Commission (the "Commission") solicited comments on its proposed rules to implement Section 725(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank", and such rules, the "Proposed Rules").

ISDA was chartered in 1985 and has over 800 member institutions from 54 countries on six continents. Our members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter ("OTC") derivatives to manage efficiently the risks inherent in their core economic activities.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business through documentation that is the recognized standard throughout the global market, legal opinions that facilitate enforceability of agreements, the development of sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

Below are comments reflecting the consensus of an ISDA working group comprised of firms representing both buy-side and sell-side perspectives regarding considerations relevant to the Proposed Rules.

As ISDA has identified in several of its comment letters on various rulemakings, we believe that terms used in the cleared swap market should be clearly differentiated from terms used in the uncleared market when the definitions used are different.

We are concerned that the definitions of "Initial Margin" and "Variation Margin" in the Proposed Rules are more appropriate to the futures markets and cleared derivatives and less readily applicable in the uncleared OTC derivatives context. We also believe that if these terms are to be used in this and other Commission rules that reference cleared transactions (whether futures or swaps), their use will create confusion with the equivalent concepts used in the uncleared OTC derivatives markets, which are distinguishable for the reasons noted below.

First, unlike the futures markets, market participants in the uncleared OTC derivatives markets do not "pay" variation margin to each other in settlement of changes in market value. Rather, each day during the life of a swap[1] (or portfolio of swaps), they post (and grant a security interest[2] in) varying amounts of collateral or other credit support that reflects an estimate (typically at mid-market) of the amounts that would be payable between the parties if the transaction(s) were terminated at such time.[3, 4]

Second, the rough equivalent of initial margin in the uncleared OTC derivatives context is referred to as "Independent Amount". In contrast to the futures markets, where initial margin levels are typically fixed by a clearing house or exchange and is applicable to **all** cleared transactions, the amount of Independent Amount to be posted in respect of an uncleared swap (or a portfolio of uncleared swaps) is negotiated by the parties and may either be a fixed amount or an amount that may be adjusted over time.[5] Although Independent Amount generally is not defined by reference to a particular purpose, often it is intended to protect the Independent Amount holder against volatility that might occur during the life of a transaction or during the close-out process.[6]

Given these distinctions, we have previously commented in connection with the proposed regulations on segregation of initial margin in respect of uncleared OTC derivatives that, in order to avoid confusion, the standard terms customarily employed in the uncleared OTC derivatives markets to refer to amounts of collateral posted by parties to uncleared swaps should be used instead of "Initial Margin" and "Variation Margin".

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[1] As used in this letter, "swap" has the meaning ascribed in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

[2] It is worth noting that, under one of ISDA's English law-governed Credit Support Annexes, title to credit support is transferred to the Secured Party (rather than having a security interest granted to the Secured Party in such credit support). However, the large majority of collateral posted in respect of OTC derivatives transactions in the United States is governed by a New York law-governed ISDA Credit Support Annex that provides for the grant of a security interest to the Secured Party rather than a title transfer.

[3] Parties often agree that swaps will be valued for this purpose as of the close of business on the business day preceding the day of the collateral call.

[4] Such estimate is defined in ISDA documentation as the "Exposure" of the party that would be entitled to receive a payment in the event of an early termination (typically calculated at mid-market).

[5] The agreed level of Independent Amount may be specified in advance in the parties' swap master agreement or negotiated on a transaction-by-transaction basis. Parties may agree to allow for adjustments to Independent Amount levels due to, for example, changes in market volatility. In addition previously agreed levels of Independent Amount are sometimes reduced in circumstances where portfolio or other cross-margining arrangements are put in place.

[6] It is worth noting that the treatment of variation margin differs across futures and cleared OTC derivatives. The cleared OTC derivatives market currently follows the practice in the uncleared OTC derivatives market of posting collateral in respect of changes in market value rather than making a settlement payment.

Specifically, we propose the following definition of "Exposure Collateral" instead of "Variation Margin" for the uncleared market:

> "Exposure Collateral" means money, securities or property posted by a party to secure its obligations pursuant to the terms of a swap agreement, the amount of which is based on an estimate of the net mark-to-market exposure of all transactions under the master swap agreement with respect to uncleared transactions.

Since Independent Amount is an amount that is defined by the parties and calculated on a basis that is distinct from the Exposure Collateral calculation, we propose the following definition of "Independent Amount" instead of "Initial Margin" for the uncleared market:

> "Independent Amount" means money, securities or property posted by a party to secure its obligations pursuant to the terms of a swap agreement and that is either (i) specified as an "Independent Amount" in the relevant agreement of the parties or (ii) calculated based upon terms agreed between the parties (in either case, in addition to and separately from any Exposure Collateral requirement) with respect to uncleared transactions.[7]

Since the proposed rules implementing Section 725(c) are applicable to the cleared market, we believe that the definitions used in the final rules should expressly provide that they only apply to cleared derivatives in order to avoid any confusion. As such we would recommend the following definitions in lieu of the proposed definitions for section 1.3 (changes in italics):

> (jjj) *Clearing initial margin.* This term means initial margin posted by a clearing member with a derivatives clearing organization.
> (kkk) *Customer initial margin.* This term means initial margin posted by a customer with a futures commission merchant, or by a non-clearing member futures commission merchant with a clearing member *with respect to cleared transactions and/or positions*.
> (lll) *Initial margin.* This term means money, securities, or property posted by a party to a futures, option, or swap as performance bond to cover potential future exposures arising from changes in the market value of the position *with respect to cleared transactions and/or positions*.
> (mmm) *Margin call.* This term means a request from a futures commission merchant to a customer to post customer initial margin; or a request by a derivatives clearing organization to a clearing member to post clearing initial margin or variation margin. *Such Margin call will clearly identify if it is with respect to a cleared or uncleared transactions and/or positions.*
> (nnn) *Spread margin.* This term means reduced initial margin that takes into account correlations between certain related positions held in a single account *with respect to cleared transactions and/or positions*.
> (ooo) *Variation margin.* This term means *(a)* a payment made by a party to a futures *or* option or *(b) money posted by a party to a* swap, *in either case* to cover the current exposure arising from changes in the market value of the position since the trade was

[7] In light of these proposed changes to the definitions of Initial Margin and Variation Margin, we would propose a corresponding replacement of the definition of "Margin" with the following: "Uncleared Swap Collateral" means both Exposure Collateral and Independent Amount.

executed or the previous time the position was marked to market *for cleared transactions and/or positions*.

To the extent that the terms "Initial Margin" and "Variation Margin" are defined in other Commission rules (e.g., with respect to cleared swaps), we would recommend that the Commission clearly delineate the application of such defined terms and take account of how the concepts may vary for futures, cleared swaps and uncleared swaps.

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ISDA appreciates the ability to provide its comments on the Proposed Rules and looks forward to working with the Commission as you continue the rulemaking process. Please feel free to contact me or ISDA's staff at your convenience with any questions.

Sincerely,

Robert G. Pickel

Robert Pickel

Executive Vice Chairman