

BY EMAIL

29 July 2022

Financial Supervisory Service (“FSS”)
Capital Market Supervision Department
Derivatives Market Team
Attention: Kyu Yeon LEE, Senior Manager

Consultation on Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Transactions

The International Swaps and Derivatives Association (“ISDA”)¹ welcomes this opportunity to provide comments to the FSS’s consultation on the Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Transactions (“**Draft Margin Guidelines**”). Individual members of ISDA may have their own views on the Draft Margin Guidelines, and may therefore provide their comments to the FSS directly.

Consistent with our mission, we are primarily concerned in this letter with the impact of the proposed implementation on the safety and efficiency of the financial markets, by considering the impact of the proposals on the obligations of a financial institution with respect to the trading of over-the-counter (“**OTC**”) derivatives.

Our membership includes the leading global, regional, and national financial institutions as well as leading end-users and many other important financial market participants. Our leading financial institution members are also members of the other international financial trade associations, and their views on certain other issues will be further represented to you through those associations.

1. Extension of the exemption for equity options

We note in the proposed Draft Margin Guidelines that there is not a further extension of the exemption from the application of the margin requirements for equity options.

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 990 member institutions from 78 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.

We would like to draw your attention to the approach taken in other jurisdictions in respect of equity options. There are jurisdictions that have not implemented margin requirements for single-stock options, equity basket options and equity index options, or are out of scope of their relevant margin rules; or have also introduced temporary derogations or granted permanent exemptions for these transactions.

- (i) For example, in the United States of America (“US”), equity options and equity index options are not addressed within the scope of Dodd Frank Title VII² (which only applies to OTC derivatives and under US laws, equity options and equity index options are considered “securities” and not “derivatives”), and regulatory margin requirements do not in practice apply to swap dealers of such products under US regulation. Given that the US is the largest market for equity options³, alignment with the US in this regard will be important to avoid disruption of cross-border business.
- (ii) Another example is in Singapore where the Monetary Authority of Singapore (“MAS”) has released guidelines⁴ exempting equity options and equity index options from the scope of its margin rules entirely (Paragraph 4.2(f) of the MAS Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Contracts).
- (iii) Another example is the approach taken by the European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority (together, the “ESAs”) (Commission Delegated Regulation (EU) 2021/236 Art. 38(1))⁵, who granted an extension until 4 January 2024 for the temporary exemption from the requirement to exchange margin for single-stock equity options and equity index options. The UK Prudential Regulation Authority (by PRA Standards Instrument: The Technical Standards (Bilateral Margining) Instrument 2021)⁶ and the UK Financial Conduct Authority (by PRA Standards Instrument: The Technical Standards (Bilateral Margining) Instrument 2021)⁷ have granted a similar derogation until 4 January 2024.
- (iv) Further, the approach taken in Hong Kong has been similar:
 - (a) the Hong Kong Monetary Authority has extended the exemption for non-centrally cleared single-stock options, equity basket options and equity index options from the relevant margin requirements, until further notice (footnote 13 to paragraph 2.1.2(ii)(v) of the Supervisory Policy Manual CR-G-14 Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards)⁸; and
 - (b) the margin requirements of the Hong Kong Securities and Futures Commission (“**Hong Kong SFC**”) do not apply to, on or before 3 January 2024, non-centrally

² See joint SEC/CFTC Product Scope Rule:

<https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2012-18003a.pdf>

³ <https://stats.bis.org/statx/srs/table/d8?f=pdf>

⁴ <https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Fund-Management/Regulations-Guidance-and-Licensing/Guidelines/Guidelines-on-Margin-Requirements-for-NonCentrally-Cleared-OTC-Derivatives-Contracts-29-Jun-2021-2.pdf>

⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0236&rid=8>

⁶ <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/june/ps1421appl.pdf>

⁷ https://www.handbook.fca.org.uk/instrument/2021/FCA_2021_21.pdf

⁸ <https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CR-G-14.pdf>

cleared single-stock options, equity basket options and equity index options (Schedule 10, paragraph 7(e) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission).⁹

We would ask the FSS to amend the Draft Margin Guidelines to:

- (I) exclude equity options and equity index options from the margin requirements permanently; or
- (II) at least, to extend the relief for equity options and equity index options until 4 January 2024 to align with the approach taken by the ESAs, the UK and Hong Kong SFC,

to avoid an unlevel playing field for Korean market participants engaged in global derivatives markets and to reduce pressure for Korean market participants in their preparations for Phase 6 (particularly, if the inclusion of their equity option book is significant enough to push their overall exposure past the initial margin (“**IM**”) threshold amount).

2. Foreign currency-based threshold amounts - IM

We welcome the clarification from the FSS that, in respect of transactions between a Korean financial institution and a foreign financial institution, where a foreign currency-based threshold amount for IM is applied (based on the conversion from KRW 65 billion at the time of entering into the relevant agreement) and subsequently, the IM threshold amount if converted into Korean won (“**KRW**”) would exceed KRW 65 billion due to fluctuations in the exchange rate, the parties will not be deemed to be in violation of the Draft Margin Guidelines and need not exchange additional IM.

However, we would like to draw your attention to the following:

- (i) ***Korean financial institutions***: In practice, a foreign currency-based threshold amount for IM could also be used in respect of transactions between two Korean financial institutions. As such we would request that the clarification in relation to a foreign currency-based threshold amount for IM be applied generally and not only to transactions between a Korean financial institution and a foreign financial institution.
- (ii) ***Specifying a foreign currency-based threshold***: To provide equality between parties who enter into agreement at different times and not be subject to the currency fluctuations that occur, we would like to request that the FSS, in addition to specifying that the IM threshold is KRW65 billion, to also, specify a foreign currency-based threshold amount for IM that is comparable to KRW65 billion within the Draft Margin Guidelines. A suggestion would be to allow using an IM threshold limit of USD50 million and/or EUR50 million, in accordance with the IM threshold that is applicable

⁹ https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/codes/code-of-conduct-for-persons-licensed-by-or-registered-with-the-securities-and-futures-commission/Code_of_conduct-Dec-2020_Eng.pdf

under the US¹⁰ and EU¹¹ regimes, notwithstanding that while they may not be exactly KRW65 billion currently, such thresholds have been below and comparable to the KRW 65 billion in previous years.

This is important as certain financial institutions, particularly foreign financial institutions, may not be able to agree to a KRW IM threshold and so if the FSS could specify that certain foreign currency-based thresholds are also acceptable, this would facilitate efficiency and create a fair market and standard for all relevant Korean financial institutions that are subject to the Draft Margin Guidelines. This would also eliminate the issue of potentially breaching the KRW threshold due to currency fluctuations.

3. Foreign currency-based Minimum Transfer Amount

We would also like to request that the FSS consider applying the clarification regarding the currency fluctuations that affect foreign-currency threshold amounts to the Minimum Transfer Amount (“MTA”), such that if a foreign currency-based amount is agreed as the MTA (based on the conversion from KRW 1 billion at the time of entering into the relevant agreement), and subsequently, the foreign-currency-based MTA, if converted into KRW would exceeds KRW 1 billion due to fluctuations in the exchange rate, the parties would not be deemed to be in violation of the Draft Margin Guidelines and need not start transferring IM and/or variation margin (as the case may be) prior to reaching the foreign-currency-based MTA.

Alternatively, we would request, that the FSS consider specifying a foreign currency-based MTA which is deemed to be comparable to KRW 1 billion under the Draft Margin Guidelines. A suggestion would be to use the MTA limits such as USD500,000 and EUR500,000, in

¹⁰ The US regime refers, collectively, to the Prudential Regulators (the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC)), *Margin and Capital Requirements for Covered Swap Entities*, see <https://www.federalregister.gov/documents/2020/07/01/2020-14097/margin-and-capital-requirements-for-covered-swap-entities> (“PR Margin Rules”), the Commodity Futures Trading Commission (“CFTC”) *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, see <https://www.cftc.gov/LawRegulation/FederalRegister/finalrules/2020-27736.html> (“CFTC Margin Rules”) and the Securities and Exchange Commission (“SEC”) *Security-Based Swaps Capital, Margin and Segregation Rules*, see <https://www.sec.gov/rules/final/2019/34-86175.pdf>, (“SEC Margin Rules”). PR Margin Rules, CFTC Margin Rules and SEC Margin Rules all contain a USD 50 million IM threshold.

¹¹ The EU regime refers to EU Delegated Regulation 2016/2251, the regulation that specifies margin requirements for uncleared OTC derivatives adopted by the European Commission (EC) on October 4, 2016 and entered into force on January 4, 2017. A EUR 50 million IM threshold is taken into account when applying the regulation, see Article 29, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02016R2251-20200416>. Additionally, the UK applies onshore UK version of the EU Margin Rules as it forms part of UK law pursuant to the European Union (Withdrawal) Act 2018 (EUWA).

accordance with the MTA that is applicable under the US¹² and EU¹³ regimes.

As mentioned above, this would be most beneficial to certain financial institutions, particularly foreign financial institutions, who are not able to agree to Korean won-based thresholds and MTA. If the FSS could specify that certain foreign currency-based thresholds and MTA are also acceptable, this would facilitate efficiency and create a fair market and standard for all relevant Korean financial institutions that are subject to the Draft Margin Guidelines. This would also eliminate the issue of potentially breaching the relevant KRW-based threshold and MTA due to currency fluctuations.

Should you have any questions or desire further clarification on the matters discussed in this letter, please do not hesitate to contact the undersigned.

Yours faithfully,

For the **International Swaps and Derivatives Association, Inc.**

¹² Under CFTC Margin Rules, §23.153(c), see <https://www.govinfo.gov/content/pkg/CFR-2021-title17-vol1/pdf/CFR-2021-title17-sec23-153.pdf>. Such regulation states: (c) Minimum transfer amount. A covered swap entity is not required to collect or to post variation margin pursuant to §§ 23.150 through 23.161 with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to §§ 23.150 through 23.161 to be collected or posted and that has not been collected or posted with respect to the counterparty is greater than \$500,000; The SEC also increased the minimum transfer amount from USD 100,000 to USD 500,000 in the Final Rule to be consistent with CFTC, see paragraph (c)(2)(iii)(D) of Rule 18a-3, as adopted. <https://www.sec.gov/rules/final/2019/34-86175.pdf>

¹³ Article 25, EU Delegated Regulation 2016/2251, The minimum transfer amount shall not exceed EUR 500 000 or the equivalent amount in another currency. See <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02016R2251-20200416>