

**ISDA response to the Bank of Russia consultation paper on mandatory margining of non-centrally cleared OTC derivatives**

The International Swaps and Derivatives Association ("**ISDA**") welcomes the opportunity to respond to the Bank of Russia's consultation paper on mandatory margining of non-centrally cleared OTC derivatives ("**NCC derivatives**").

We support and appreciate the efforts of the Bank of Russia to align its proposed requirements for the margining of NCC derivatives with the joint standards document of the BCBS and IOSCO 'Margin Requirements for Non-Centrally Cleared Derivatives' (the "**BCBS-IOSCO Standards**"), and in doing so, its consideration of the regulations promulgated by other G20 regulators to promote reduction of systemic risk. This response is intended to facilitate constructive dialogue between Bank of Russia and derivatives market participants and to focus on the practical concerns and risks surrounding the implementation of uncleared margin requirements. In particular, we would like to highlight the following specific concerns:

**A. Globally Harmonized Requirements**

Regulatory requirements for the margining of NCC derivatives have been finalized or are in effect in major jurisdictions across the globe. As the derivatives market is global in nature, these regulations have significant cross-border impact. Variations in these regulations greatly affect the complexity and cost of compliance and may substantively affect the ability to maintain a level playing field that fosters the health of the global derivatives marketplace. We observe, for instance:

- the proposed thresholds for compliance with the margin regulations are substantively different than those in the BCBS-IOSCO Standards, and we question the potential for arbitrage this may create. See question 7 for our additional feedback on this point.
- the proposed minimum transfer amount is three times higher than BCBS-IOSCO Standards, and we suggest alignment. See question 8 for further information.

**B. Non-Netting Jurisdictions**

Under the EU rules, the EMIR margin RTS provides a special treatment for derivatives transactions entered into with counterparties located in countries where legal enforceability of netting agreements or collateral protection cannot be ensured (see [Margin RTS](#), article 31).

Under this provision, by way of derogation from margin requirements, counterparties that in theory have to collect variation and initial margins are not required to be posted if their counterparty is located in a jurisdiction where netting agreements and, where used, exchange of collateral agreements are not enforceable.

ISDA would support the addition in the Russian rules of such a provision. The non-enforceability should be based on the fact that there is no existing legal opinion on the enforceability of netting agreements or collateral agreements.

**1. Do you think that the categories of NCC derivatives as per Table 2 which are subject to mandatory margining are optimal? If not, please explain and suggest alternatives, if possible.**

We support the exclusion of FX forwards and swaps and physically settled commodity derivatives from both variation margin (“VM”) and initial margin (“IM”) requirements, as well as the carve-out from IM for principal payments on cross-currency swaps.

**2. Do you consider it is necessary to exclude from the list of derivatives subject to mandatory margining, derivatives with duration less than 30 calendar days? If yes, please suggest possible exceptions and provide the appropriate substantiation.**

**3. Do you have any comments/suggestions regarding the classification of participants in the OTC derivative market for adoption of the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.**

We observe that the Category 1 entities are not very precisely defined compared to equivalent U.S. and EU definitions. Is it the intention that they be further defined in the final version of the margin regulations by reference to Russian regulatory requirements for entities performing those functions? And are the foreign entities a more limited class or would they be all foreign entities that would be categorized as Category 1 if they were located in Russia (i.e. similar to the U.S./EU approach)? It would be helpful if the foreign entities were more limited, as it can be difficult for a foreign entity to do the “equivalence” analysis to determine what its regulatory status would be under another law.

**4. Do you have any comments/suggestions regarding the criteria for assignment to a certain group for the purposes of adopting the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.**

**5. Do you have any comments/suggestions regarding the list of persons who will not be covered by the mandatory margin requirement (certain entities)? If so, please state them in detail.**

We strongly support the proposal to except intra-group derivatives from the margin requirements. To avoid uncertainty, we would prefer that such exception not be premised on an application for exemption but be generally afforded to groups of entities that meet the specified definition.

ISDA further supports the proposal that international financial institutions, (such as multilateral development banks, International Finance Corporation) and foreign central banks should be excluded from the mandatory margining requirements.

**6. Do you have any comments/suggestions regarding the terms for phasing in the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.**

We support a phased-in approach to compliance, however, we suggest that the Bank of Russia align its annual phase-in dates for IM with those in the BCBS-IOSCO Standards and as widely adopted by other regimes (i.e., on September 1 of each year). Rolling compliance dates in July of each year for a single jurisdiction will add significant complexity to the implementation schedules for global firms. The consultation proposes to align with the BCBS-IOSCO period for calculating aggregate month-end notional amount (i.e., March, April and May of each year); however, the month between the end of this calculation period and the corresponding application of IM or VM regulations on July 1 is entirely insufficient. Section 2.3 also refers to a requirement that margining would be mandatory for trades that exceed the threshold during the proposed assessment period for NCC derivatives executed from October 1 of the same year. It is unclear how the October 1 milestone fits into the proposed compliance schedule.

The scope of the preparations is significant and the time needed to complete the relevant documentation and make the necessary technical changes, including the implementation and testing of an IM model, is substantial and can vary based on a firm's existing capabilities. As it stands, the May to September window afforded by the BCBS-IOSCO Standard requires firms to begin preparations before they are certain they will be subject to the regulations. Any shorter period is impractical and would not be achievable. Compliance dates in July will not allow firms subject to the Bank of Russia's regulations to efficiently coordinate with other firms and custodians regarding documentation and operational changes based on a uniform timetable.

ISDA also wishes to ensure that the Bank of Russia has sufficient time to review the SIMM model and provide the relevant approval to SIMM users. In addition, as SIMM is recalibrated annually, it is more practicable to consider the timing of the recalibration based on the September rolling cycle.

**7. Do you have any comments/suggestions regarding the threshold values for the purposes of adopting the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.**

In order to prevent potentially unintended impact to non-financial corporate clients in Russia, we suggest that hedging activity should be excluded from the calculation of the thresholds for VM. This is similar to the approach under the EMIR regulations for non-financial entities.

ISDA observes that both the VM and IM thresholds for the phased-in compliance dates are substantially lower than those established in the BCBS-IOSCO Standard and established thresholds for clearing mandates (e.g. EUR 3 billion for interest rates and foreign exchange). We recognize that these lower thresholds are intended to capture entities that may otherwise fall outside of the scope of the requirements. However, we note that such an approach is globally inconsistent and could result in disadvantaging domestic counterparties, especially those that trade with other domestic entities. Due to the potential to comply with the regulations which correspond to the foreign entity, it may incentivize domestic entities to trade with foreign counterparts with whom the transactions may remain below the threshold for regulatory IM and/or VM.

**8. Do you find the rules set forth in Clause 2.3. for the Minimum Transfer Amount to be optimal? If not, please explain and suggest alternatives, if possible.**

We generally support the application of a minimum transfer amount principle by which a collecting counterparty may agree not to collect collateral where the amount due from the last collection of collateral is equal to or lower to a certain amount. We note that the RUB 100 million threshold is three times higher than the threshold set in the EU rules (which is €500 000, i.e. around RUB 31.5 million) and under the US rules (USD 500 000, i.e. around RUB 28.5 million). To ensure consistency, we would suggest an equivalent threshold to be applied under Russian rules, e.g. RUB 30 or 35 million.

In addition, we would suggest clarifying that where the Category 1 entity is a licensed manager of collective investment scheme (fund), and the derivative is entered into on behalf of such collective investment scheme (fund), the thresholds for MTA are calculated in respect of such collective investment scheme (fund) and its subsidiaries, and not in respect of the licensed fund manager and its group members.

**9. Do you think a 99% confidence interval and 10-day horizon are good parameters for calculation of Initial Margin for the Russian NCC derivatives market? If not, explain why, and suggest and substantiate alternatives, if possible.**

The ISDA Standard Initial Margin Model (“SIMM”) is based on the 99% confidence interval and 10-day horizon and will be maintained to meet this standard in accordance with the BSBS-IOSCO standard and current global margin regulation. A stricter requirement would impact the ability of cross-border counterparties to use SIMM.

**10. Do you have any comments on the suggested transfer procedure and calculation periods for Initial and Variation Margins? If so, please state them in detail.**

ISDA supports the proposal in section 3.1.1. which requires that IM calculation be performed within no more than two business days of the specified events and the proposal in Section 3.2.1 that VM be calculated daily. However, depending on the collateral intended for exchange and the capabilities of the counterparties to transfer such collateral, settlement no later than the following business day may be impractical, especially in the event of cross-border transactions where the parties are in substantially different time zones. To address these concerns, some jurisdictions have provided for a longer settlement cycle (e.g. two or three business days), as may be appropriate for the relevant collateral type.

Section 3.1.3 provides that collected IM should be ‘immediately available’ to the collecting party in the event of the counterparty’s default. Depending on the collateral to be provided, the location of the relevant parties (including the custodian) and other practical reasons, we suggest this provision either be deleted or otherwise amended to accord with other global regulations to require that IM be made available ‘as soon as reasonably practicable under applicable law’.

**11. Is it necessary to limit the scope of persons entitled to develop and apply their own quantitative portfolio margin models for Initial Margin calculation? If yes, what requirements should apply to such persons?**

We do not believe that regulatory limitations on the scope of persons entitled to develop and apply an initial margin model are necessary. For the sake of efficiency, cost mitigation, regulatory compliance and cross-border harmonization, participants in the derivatives industry will coalesce around a single, or a very limited number, of initial margin models.

We appreciate the acknowledgement by the Bank of Russia of the SIMM in its proposal. The SIMM has been widely adopted across the globe by firms already subject to regulatory initial margin requirements, and is expected to be adopted broadly by firms subject to subsequent phases of global IM requirements. ISDA requests that the Bank of Russia provide approval for firms to use SIMM to comply with its requirements, and we stand ready to provide any further information regarding the model which may assist in such consideration.

We encourage the Bank of Russia to coordinate with other global regulators which have reviewed, have approved, or are accepting the use of SIMM for IM calculation under their regulations. SIMM is designed as a global model and thus any changes requested by a particular jurisdiction, impact the calculation of IM under the model for all users globally.

**12. What procedure for custody of Initial Margin do you find optimal: a) collateral can be held only with a third-party custodian; b) collateral can be held with a third-party custodian and with the Initial Margin taker? What requirements should apply to third-party custodians?**

**13. Should a pledge and/or other legal device be used to ensure adequate protection of the Initial Margin against insolvency of its taker?**

The EU and US regulations governing provision of the IM are not prescriptive as to the legal devices that may be used, but rather requires to ensure that certain conditions are met, including, inter alia, segregation of the IM from the insolvency estate of its taker. While it is true that the ISDA 2016 Phase One IM Credit Support Deed (English law governed) contemplates creation of security interest of the recipient of the initial margin, this is not because the UK or EU laws require that. It may be possible that over the course of time documentation envisaging title transfer may be developed. Accordingly, we would welcome the approach whereby the Russian legislation would not prescribe a single method for transferring the IM, because depending on circumstances different methods of transfer may be appropriate and the relevant industry bodies could develop the requisite documentation for each method of posting the initial margin. However the legislation should rather establish foundations for ensuring that the IM is effectively segregated from the insolvency estate of the taker, and at the same time, would be immediately available to the taker upon default of the provider of the IM. In this regard we believe that irrespective of the method for providing for IM further changes to the legislation will be required to ensure that the margining rules in Russia are consistent with the BCBS-IOSCO recommendations. We set out the recommended changes in respect of each of the methods for providing the margin (pledge and title transfer) in more detail in our response to question 17 below.

**14. Do you find it expedient to harmonise the methods for calculation of Initial and Variation Margins used in the central clearing of derivatives and for NCC derivatives?**

**15. Do you have any comments or proposals on the suggested types of assets for margining? If so, please state them in detail.**

The limitation of cash collateral to Rubles, EUR, USD, GBP, JPY and CHF is more restrictive than other regimes and may create a challenge for cross-border transactions. We observe that the suggested types of assets for margining are treated inconsistently, since stocks which reference other currencies (Australian, Canadian, etc.) can be used as collateral, but not the corresponding cash (e.g., AUD/CAD).

**16. Do you have any comments or proposals on the haircut rates given in Table 5? If so, please state them in detail.**

The Bank of Russia has proposed the establishment of an 8% haircut in the event the currency of the cash asset and the currency of settlements under the NCC derivatives are different. In accordance with global practices, we suggest that “currency of settlement” includes any currency designated for settlement for either cash or non-cash collateral in the relevant master netting agreement or relevant credit support annex.

In accordance with other global margin requirements, ISDA also requests that the FX haircut for VM cash be eliminated such that the FX haircut only applies to securities posted for VM to the extent those securities are denominated in a currency not specified in the relevant master netting agreement, credit support annex or the trade confirmation.

**17. Which legal device for the posting of Initial and Variation Margins do you find the most suitable? Explain your reasoning.**

As discussed in our response to question 13 above, other major jurisdictions do not prescribe specific methods for posting Initial and Variation Margin, and we do not believe it would be beneficial for Russia to prescribe a specific method in its domestic laws. It would be desirable that the legislation retains flexibility in this regard and allows the industry bodies to develop standard documentation for those methods that the industry would deem appropriate at the relevant time.

Having said that, we believe that it is important to ensure that irrespective of the legal methods for posting the Initial and / or Variation Margins the relevant BCBS-IOSCO principles are properly implemented in the legislation to allow for (a) proper segregation of the Initial Margin from the insolvency estate of the taker and (b) immediate availability of the Initial and Variation Margin to the taker upon default of the margin provider.

While the use of pledge as a method for providing the Initial Margin should allow effective segregation of the posted collateral from the insolvency estate of the taker, we would recommend that at least the following changes are introduced into the legislation to disapply the following limitations on expedite liquidation of the assets provided as collateral in respect of financial agreements (as they are defined in the Russian Securities Market Law): (a) the minimal waiting period for liquidation of pledged assets, (b) the right of the pledger to seek judicial suspension for the liquidation of the pledged assets, (c) the suspension on liquidation of the pledged assets in insolvency of the pledger and (d) the subordination of



the claims of the pledgee to the claims of the depositors of a pledger (where the pledger is a bank taking retail deposits).

As for the title transfer as a method for posting Initial and Variation Margin, we believe that it may equally be used both for Initial and Variation Margin, but similarly to pledges, it will require certain amendments to the legislation to ensure (a) that the IM is segregated from the insolvency estate of the taker, and (b) that the wider range of eligible assets (and not only cash) can be effectively utilized for margining purposes. In particular, for the assets provided as collateral in respect of financial agreements (as they are defined in the Russian Securities Market Law) on the title-transfer basis the following changes are required: (a) to provide for segregated cash and securities accounts for holding collateral provided on the title transfer basis and (b) to establish the limitations on rights of use over these accounts for the recipient of the margin until the default of the relevant provider of the margin. Although such transfer of title with inherent limitations on use of transferred assets would be unusual for Russian legal system, we would expect it to be effective and enforceable if it is enshrined in law.

**18. Do you have any comments/proposals regarding the development of the services of calculation, selection, and revaluation of the collateral in Russia? If so, please state them in detail.**

**19. Do you have any comments/proposals regarding the standardisation of documents required for margining? If so, please state them in detail.**

ISDA has published a series of Regulatory Margin Self-Disclosure Letters<sup>1</sup> (“SDLs”) intended to assist market participants with the exchange of the necessary information to determine if, and when, their trading relationship will become subject to regulatory margin requirements for non-cleared derivatives. If useful to the industry, ISDA is open to producing an SDL for the Bank of Russia’s requirements for the margining of NCC derivatives, which could include both the counterparty category and the threshold level relevant to the associated group.

**20. Do you find the special rules for the regulation of cross-border transactions specified in this Chapter to be optimal? If not, please explain and suggest alternatives, if possible.**

ISDA supports the proposal that mandatory margining requirements will not apply to derivatives contracts which are cleared through a foreign central counterparty. We strongly support the proposed position to allow both the foreign entity and the Russian entity to comply with the margining rules of the jurisdiction of the foreign entity which has been recognized by the Bank of Russia. We would encourage the Bank of Russia to recognize all other G20 jurisdictions which have finalized their corresponding regulations, providing sufficient notice (i.e. six months) in advance of the relevant compliance date in order to avoid uncertainty or the necessity for firm-specific changes to technology builds.

We request that additional specificity be provided with respect to the primary condition for application of the proposed cross-border rules, i.e., “If according to the lex societatis of a foreign entity, it is subject to a mandatory margining requirement”, including the treatment of trades entered into by foreign branches (both a Russian branch of a foreign entity and a branch subject to margin requirements based

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<sup>1</sup><http://www2.isda.org/functional-areas/wgmr-implementation/isda-regulatory-margin-self-disclosure-letter/>

on the location of its branch rather than its home office), application to trades that are subject to margin requirements because of the location of a guarantor rather than the counterparty, and application to foreign consolidated subsidiaries under U.S. rules (i.e., a legal entity might be subject to U.S. requirements based on its U.S. registration status and U.S. ownership rather than the rules of the jurisdiction in which it is incorporated). Specifically, we suggest that the proposed approach to the treatment of cross-border transactions should apply to derivatives transactions entered into by a foreign entity through one of its branches, such that the margin regulations applicable in the location of the branch may apply, regardless of whether the foreign entity is domiciled or maintains its head office in a jurisdiction which is specified on the list established by the Bank of Russia. Similarly, we suggest the application of the cross-border rules should be allowed in each of the circumstances described above in which an entity is subject to margin regulations for reasons other than its primary domicile.

With respect to being “subject to a mandatory margining requirement” for the purpose of the proposed cross-border rules, we interpret that if the *lex societatis* of the counterparty is on the Bank of Russia’s list, then that counterparty is automatically considered “subject to a mandatory margining requirement”, without the need to analyze whether that individual counterparty must comply with any particular requirements under the margin regulations of that jurisdiction. A clarification on this point from the Bank of Russia would be a useful inclusion to the regulations to eliminate ambiguity and avoid divergent interpretations and implementations.

We thank the Bank of Russia for considering our comments and the comments of other industry stakeholders in this process. We look forward to continued dialogue on these issues going forward. Should you have any questions, please do not hesitate to contact Tara Kruse ([tkruse@isda.org](mailto:tkruse@isda.org)) and Benoît Gourisse ([bgourisse@isda.org](mailto:bgourisse@isda.org)).