22 August 2014

The European Securities and Markets Authority
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07, France
Attention: Steven Maijoor, Chair

The European Banking Authority
Tower 42 (level 18)
25 Old Broad Street
London EC2N 1HQ|UK
Attention: Andrea Enria, Chairperson

The European Insurance and the Occupational Pensions Authority
Westhafenplatz 1
60327 Frankfurt am Main
Germany
Attention: Gabriel Bernardino, Chairman

Re: Proposed Margin Rules:

Ladies and Gentlemen,

The International Swaps and Derivatives Association[1] ("**ISDA**") is concerned about the practical consequences of certain provisions of the margin requirements under the Draft RTS on risk-mitigation techniques[2]. These concerns were raised in brief in the letter we sent to the ESAs on 14 July commenting generally on the Draft RTS (the "**July Letter**"). This letter is intended to

[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] Consultation Paper (the "**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.

provide further detail and we would welcome the opportunity to discuss this further with the ESAs.

1. Immediate Access to Initial Margin

(i) Chapter 4, Article 1(4)(a) SEG of the Draft RTS states that the segregation arrangements for initial margin ("**IM**") must ensure that the initial margin is immediately available to the collateral taker when the collateral provider defaults.

(ii) As noted in the July Letter, many jurisdictions, both in and outside of the EU, impose stays or other restrictions on the enforcement of certain rights in the case of relevant insolvency proceedings in that jurisdiction. Such restrictions are particularly common in the case of collateral provided through a security interest collateral arrangement. The requirements of the Draft RTS suggest that a form of security interest collateral arrangement is likely to be used for IM. We note that article 70 of the Bank Recovery and Resolution Directive ("**BRRD**") contemplates a moratorium on enforcement of security interests.

(iii) Under the laws of some EU jurisdictions it may be possible to structure the IM collateral arrangement as a "security financial collateral arrangement" such that the national implementation of the Financial Collateral Directive should provide relief against the imposition of a stay or other restrictions on the enforcement of certain rights in the case of relevant insolvency proceedings in that jurisdiction. However, this would not remove the concern in relation to EU jurisdictions as Art 118 of BRRD amends the Financial Collateral Directive to ensure that the moratorium provisions of BRRD (notably Art 70) would apply to a "security financial collateral arrangement". As set out in Section 2 below, there are challenges in both EU and non-EU jurisdictions when using security interest collateral arrangements.

(iv) If the ESAs impose an "immediately available" standard without regard to applicable insolvency rules, then arguably EU entities would be prohibited from entering into derivatives with counterparties in a significant number of jurisdictions. Annex A highlights some key jurisdictions where it would not be possible to satisfy the "immediately available" test in some circumstances based on a literal reading of that test.

(v) In addition to applicable insolvency rules, "immediate availability" may also be an issue from a practical perspective. For example:

(A) The bulk of collateral collected as initial margin is likely to be intermediated securities held in a clearing system requiring the collateral provider to deliver appropriate instructions and wait for delivery of the relevant securities in accordance with standard settlement cycles.

(B) Where a third party custodian is used to achieve the required segregation as contemplated by Chapter 4, Article 1(1) SEG the risk of a delay before IM collateral is available to the collateral provider is increased. Such delay may arise due to operational requirements (for example, notification timing) or legal restrictions (for example, injunctive relief prohibiting the custodian from transferring assets pending resolution of a dispute or the existence of a lien or other prior ranking security interest in favour of the custodian which would need to be discharged before the collateral taker is permitted access to the IM collateral).

(vi) We assume that a literal interpretation of "immediately available" was not intended and as such a legal opinion confirming that the relevant collateral arrangement provides a suitable security interest under the laws of the relevant jurisdiction would be sufficient. As noted in the July Letter, adoption of "in a timely manner" would better address this point. We do not consider the adoption of "in a timely manner" would result in any increase in risk for collateral takers.

2. Enforceability of Collateral Agreements in Certain Jurisdictions

2.1 Background

(i) The English law 1995 ISDA Credit Support Annex (Bilateral Form – Transfer) (the "**English CSA**") is the predominant form of collateral arrangement used by EU entities to collateralise over-the-counter derivatives. The English CSA is a title transfer collateral arrangement under which the collateral provider transfers ownership in collateral to the collateral taker. The English CSA relies on close-out netting (rather than security enforcement) to deliver protection to the collateral taker on a default.

(ii) In the case of a title transfer collateral arrangement, the collateral provider has no continuing proprietary interest in the collateral it provided but merely a conditional personal right against the collateral taker to re-deliver fungible equivalent assets or, in default circumstances, to the value of such assets at the time of the default. There is no contractual restriction on the collateral taker's right to deal with the collateral as it sees fit, including the right to sell or otherwise dispose of such collateral. In the event of the insolvency of the collateral provider, the collateral will form part of the estate of the collateral taker and the collateral provider will be an unsecured creditor of the collateral taker to the extent that the value of the collateral provided exceeds total liabilities owed by the collateral provider to the collateral taker under the relevant derivatives agreement.

(iii) The English CSA should be contrasted with security interest collateral arrangements (for example, the New York Law 1994 ISDA Credit Support Annex (Bilateral Form and the 1995 ISDA Credit Support Deed (Bilateral Form – Security Interest)), under which, in general terms, the collateral provider retains an interest in the relevant collateral.

(iv) In the case of a security interest collateral arrangement, the collateral provider remains, subject to the encumbrance it has created, the owner of the assets delivered as collateral. This means that the rights of the collateral taker in respect of re-use of the collateral may be restricted and the parties may agree terms on which the collateral will be segregated from other proprietary assets of the collateral taker. In the event of the insolvency of the collateral taker, the collateral assets do not form part of the estate of the collateral taker and are not available to satisfy the general creditors of the collateral taker.

(v) The emergence of a title transfer collateral arrangement as the preferred approach in Europe was driven by a desire to avoid cumbersome and impractical rules in many jurisdictions for creating, perfecting, maintaining and enforcing a security interest collateral arrangement. Title transfer collateral arrangements remain the preferred approach (and, in some cases, the only practical approach), both in the EU, despite the implementation of the Financial Collateral Directive which offered support for certain security arrangements, and outside of the EU, where there may or may not be equivalent laws to the Financial Collateral Directive. The English CSA provided a scalable approach where a single market standard document could be used in multiple jurisdictions.

(vi) With any collateral arrangement a vital consideration is the enforceability of that arrangement under the laws of the jurisdiction of the relevant counterparty in the event of that entity becoming subject to insolvency proceedings. The enforceability of the English CSA in the event of an insolvency of the collateral taker or collateral provider is supported by legal opinions commissioned by ISDA. Those opinions currently cover 51 jurisdictions, including both EU and non-EU jurisdictions.

(vii) It is expected that EU entities will continue to use a title transfer collateral arrangement (based on a Draft RTS compliant version of the English CSA) for collection of variation margin from counterparties in jurisdictions which have well established netting regimes and corresponding legal opinions.

(viii) EU entities currently transact with counterparties in jurisdictions which do not have a legal framework in place in respect of the enforceability of the netting provisions under the English CSA and therefore legal opinions are not available for those jurisdictions. Where that is the case, EU entities do not use the English CSA and instead will accept higher capital requirements associated with gross and uncollateralised risk positions and/or, where possible, will put in place an alternative collateral arrangement which is legally enforceable.

2.2 Concerns

(i) We are concerned that certain requirements of the Draft RTS will force EU entities to decide between accepting incremental risk or ceasing trading activity with entities in certain jurisdictions. This puts EU entities at a commercial disadvantage and potentially denies entities in those jurisdictions access to the European derivatives markets.

(ii) These concerns flow from two aspects of the Draft RTS:

(A) The Draft RTS arguably require collection of collateral from counterparties in jurisdictions where the English CSA is not legally enforceable. The Draft RTS do not expressly allow flexibility to accept higher capital requirements as an alternative, even though this is expressly contemplated by Article 11(4) of Regulation (EU) No 648/2012 ("EMIR"). Relevant jurisdictions include China, Qatar, Oman, Kuwait, Saudi Arabia and the UAE.

(B) The requirements of Chapter 4, Article 1(1) SEG and Article 1(1) REU are incompatible with using only the title transfer approach of the English CSA for collection of IM.

(iii) Given the challenges discussed in section 2.1 above, developing an alternative collateral arrangement that would be appropriate and effective across all, or most, relevant jurisdictions would be very difficult. It may be possible to develop bespoke security interest collateral solutions which are legally enforceable in specific jurisdictions and to obtain related legal opinions but this is not a scalable solution. This would involve detailed analysis in each relevant jurisdiction into the applicable rules for creating, perfecting, maintaining and enforcing a security interest collateral arrangement. We do not expect that a single market standard document would work in all relevant jurisdictions. The operational, legal and documentation burden of this should not be underestimated. We refer you to our letter dated 18 August 2014 titled "Timing issues for margin rules for uncleared derivatives" for a broader discussion of our concerns in relation to timing for implementation of the margin requirements.

(iv) Inevitably there will be jurisdictions where it will not be possible or practicable to develop a legally enforceable collateral arrangement that satisfies the requirements of the Draft RTS. If EU entities elect to continue to transact with counterparties in those jurisdictions they may be required to collect collateral - and commercial reality suggests that in some cases they will also be required to provide collateral - under arrangements which are not enforceable leading to an increase in risk assumed by EU entities.

* * *

ISDA appreciates the opportunity to provide this letter to the ESAs. Please feel free to contact me or my staff at your convenience.

Sincerely,

Stephen O'Connor
Chairman
ISDA

ANNEX A[3]

Australia: In respect of collateral arrangements involving a security arrangement, when an administration commences, enforcement will not be possible without the leave of the court or the administrator's consent.

Brazil: In respect of collateral arrangements involving a security arrangement, stays on proceedings apply in the case of a judicial reorganisation or a bankruptcy, and, in relation to a financial institution, in the case of an intervention or an extra-judicial liquidation.

Israel: In respect of collateral arrangements involving a security arrangement, during certain insolvency proceedings, a collateral taker may not enforce its security without the permission of the court.

Italy: In certain circumstances, enforcement could be delayed where a suspension of payments is put into place following the institution of reorganisation proceedings, where an order for the continuation of a business is made during compulsory administrative liquidation or during proceedings for extraordinary administration of large companies or in the case of a Financial Institution. In respect of collateral arrangements involving a security arrangement, in certain circumstances the collateral taker will be required to file a petition in order to have its claim and its right to security admitted in insolvency proceedings and a further petition will be required in order to sell collateral.

Japan: In respect of collateral arrangements involving a security arrangement, a creditor cannot enforce its security between commencement of the proceedings and finalisation of a reorganisation plan. Enforcement is also not likely to be possible in the period between application for such proceedings and commencement.

Mexico: In respect of collateral arrangements involving a security arrangement and counterparties that are not banks, enforcement will not be possible during the reorganisation stage of insolvency proceedings. A collateral taker must also register its claims by executing an agreement before a notary public in a public deed and registering the public deed in the relevant public registry of the collateral provider. Once insolvency proceedings have commenced, the collateral taker needs to file its claim, together with supporting evidence, with the bankruptcy judge.

New Zealand: In respect of collateral arrangements involving a security arrangement, no steps may be taken to enforce any security over a collateral provider's property during statutory or judicial management. In addition, in certain circumstances, a stay on secured creditors' rights can be imposed.

Norway: In respect of collateral arrangements involving a security arrangement, enforcement in accordance with local statutory requirements will be subject to a stay or freeze for six months from the commencement of debt settlement proceedings.

[3] The analysis in this annex is based on jurisdictional surveys or other advice available to ISDA. It is intended to be current but the analysis has not been verified by local counsel in each jurisdiction as accurate as at the date of this letter.

Singapore: In respect of collateral arrangements involving a security arrangement, once a winding up order is made or during judicial management proceedings a collateral taker may not enforce its security without the leave of the court.

South Africa: In respect of collateral arrangements involving a security arrangement, business rescue proceedings place a moratorium on all debts owed by a company. In the case of banks, while a bank is under curatorship, all actions, legal proceedings and legal process are stayed and may not be instituted or proceeded with, without leave of the court.

South Korea: Enforcement will not be possible upon formal commencement of rehabilitation proceedings. In addition, where protections provided by netting legislation do not apply, enforcement may be subject to interim and comprehensive stay orders and set-off must be made within a prescribed time period following commencement of rehabilitation proceedings.

Switzerland: In respect of collateral arrangements involving a security arrangement, a temporary stay on enforcement is possible where a debtor's inability to pay its debts is temporary and due to extraordinary circumstances. In the case of Swiss banks and investment firms/broker dealers, a bank moratorium or a maturity postponement may be ordered by the Swiss Financial Market Supervisory Authority. In respect of collateral arrangements involving a security arrangement, on the insolvency of a Swiss bank or securities dealer in certain circumstances, a secured creditor must surrender its collateral to the receiver in bankruptcy in order to maintain its priority status which may result in some delay.

United States: In certain circumstances, the appointment of a receiver on the insolvency of banks and systemically significant financial companies may result in a one business day stay on the termination of qualified financial contracts and the enforcement of related collateral rights. In addition, in certain circumstances on the commencement of the bankruptcy proceedings of a broker dealer, the Securities Investor Protection Corporation will have the discretion to temporarily stay the rights of creditors to dispose of any securities collateral that has been pledged by the broker-dealer in connection with financial contracts.