September 28, 2012

BBVA response to the Consultative Document on "Margin Requirements For Non-Centrally-Cleared Derivatives"

Dear all,

BBVA appreciates the opportunity to respond to the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) with respect to the Consultative Document on “Margin requirements for non-centrally-cleared derivatives” of July 2012.

EXECUTIVE SUMMARY

BBVA position on the BCBS and IOSCO Consultative Document on margin requirements for non-centrally-cleared derivatives can be summarised in the following bullet points:

- This regulation will potentially have an enormous impact on the derivative market, on the whole financial system and on the real economy.
- Before issuing a final text on mandatory margin requirements, a thorough impact analysis must be made in order to avoid potential unintended consequences.
- New mandatory margin requirements should be delayed until the impact of the new Basel III liquidity ratios is fully absorbed by the banking system.
- There should be no mandatory requirement to post collateral when the legal framework does not protect collateral and does not recognise the concept of netting.
- An exemption on margin requirements should be granted for foreign exchange transactions.
- An exemption on margin requirements should be granted for derivatives in which at least one of the parties is a government, a central bank, a not systemic non-financial institution or a SPV.
- An exemption on the obligation to post initial margin should be granted for regulated and supervised entities subject to tight capital requirements, which include specific capital charges that cover current and potential counterparty risk.
- In the case that a full exemption on the obligation to post initial margin is not granted for these entities, thresholds should apply. They should be expressed as a percentage of the entity’s capital base, which should be based on the protection the entity’s regulatory framework offers to its counterparties.
- Entities should not be allowed to develop internal models to be approved by local regulators; instead, global regulators should provide standardised models that should be applicable world wide.
- Netting should be allowed for derivatives under the same enforceable legal agreement.
- There should be no mandatory margin requirement for transactions between companies inside the same corporate group.

- Less liquid assets, even non financial assets, should be allowed to be provided as collateral for at least a portion of Initial Margin that may be considered more stable and less subject to market fluctuations.

GLOBAL COMMENTS

BBVA supports the main objectives of this document, namely, the reduction of systemic risk and the promotion of central clearing for derivatives. It also congratulates the initiative of BCBS and IOSCO in tacking this issue on a global basis, creating a global playing-field and minimizing potential regulatory arbitrage among local regulatory areas.

However, BBVA believes that establishing of margin requirements on non-centrally-cleared derivatives would have huge implications in the financial markets, with especially strong impact on collateral and liquidity, two fundamental contributors to the stability of the financial system.

- Mandatory margin requirements together with a narrow definition of collateral eligibility may create a scarcity of collateral and cause huge distortions in the markets of eligible assets.
- Mandatory margin requirements would worsen the liquidity profile of the entities involved in derivative markets, and create a liquidity drag that may potentially generate, rather than reduce, systemic risk.

This drain in liquidity and scarcity of collateral would have an effect on the real economy, potentially delaying the much needed recovery of the economic activity in developed countries.

BBVA understands that this initiative must be considered together in the context of all measures regulators across the world have already taken or proposed in the last years in order to improve the resilience of the financial system. In this sense, this proposal has to be considered as part of the package of regulatory action on:

- Capital: The BCBS, co-writer of this Consultative Document, on December 2010 published Basel III to enhance the regulatory framework for the banking system which tightens the capital standards for banking entities and considerably increases the capital charges to cover current and potential counterparty risk for OTC derivatives (new calculation methods for CCR and a new CVA charge). Similar proposals are currently under discussion for other financial regulated entities (e.g., Solvency II of insurance companies in the EU).
- Liquidity: The Consultative Document mentions the new liquidity ratios that the Basel III initiative imposes to banking entities. The impact of these requirements on the banking system is expected to be large but the full consequences on liquidity will remain uncertain until the final implementation of the obligation to comply with the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). Any new regulatory measure that implies new liquidity constraints for banking entities should be delayed until the effects of these Basel III liquidity provisions are fully understood and their impact absorbed by the banking system.

- Derivative Markets: Regulators are developing a new framework for the derivatives markets (i.e. DFA and EMIR) that already forces or incentivises central clearing. These initiatives demand a considerable period of time to be implemented, and time will also be needed for market infrastructure to be fully in place to provide access to CCPs for a large portion of derivatives. Additionally, new (FSB, G20) reporting requirements for all derivatives will allow regulators to know, in almost real time, the positions and risks generated by all market participants, and anticipate to potential problems.

BBVA believes that, although, for many, derivatives has gained a bad name during the financial crisis, OTC derivatives are an excellent, and in many cases the only, tool for end-users to manage their exposure to assets, liabilities and risk factors. In addition, some derivatives, because of its complexity, its low transaction volume or its novelty, would never have the possibility to be cleared through central clearing houses. Tough margin requirements (for some entities on top of tight capital requirements) on all positions in OTC derivatives will reduce the ability of financial entities committed to the end-user community to provide these financial tools, or make them very expensive, which would potentially affect the real economy. In addition, tough requirements on non-centrally-cleared derivatives may curtail innovation, impairing the appearance of new OTC products providing solutions to a new market reality, which would move to exchanges and/or central clearing once they reach the sufficient degree of development and critical mass.

Finally, BBVA considers that rules governing margin requirements should ensure a level playing field among institutions subject to similar capital requirements. Any better treatment given to any type of institution not justified by the protection its regulatory framework offers to counterparties, would distort the market and would potentially give them competitive advantages that would concentrate the OTC derivative markets and would lead to a higher systemic risk.

For all the points mentioned above, BBVA considers it fundamental that a thorough analysis of all potential impact is made before implementing any regulation on margin requirements (specifically Initial Margin) on non-centrally-cleared derivatives. If not, there is a high risk of dramatic unintended consequences creating a less resilient financial system that would be more prone to systemic risk.

TIMING

1. What is an appropriate phase-in period for the implementation of margining requirements on non-centrally-cleared derivatives? Can the implementation timeline be set independently from other related regulatory initiatives (eg central clearing mandates) or should they be coordinated? If coordination is desirable, how should this be achieved?

New margin requirements for non-centrally-cleared derivatives should have a long implementation period in order to accommodate the different initiatives coming from world wide regulators that affect the derivative markets, and to give market participants time to conform their activities, systems, procedures, policies, contract documentation, to this new regulatory environment.

The implementation period should be long enough to **give to markets and their participants time to**:

- Fully **develop** all **market infrastructure** that will make possible central clearing of large number of derivative through CCPs.
- Adjust their activities to the **new Basel III liquidity requirements**; new margin requirements should be implemented only after the impact of Basel III liquidity requirements (LCR & NSFR) is fully absorbed.

In addition, to lower a sudden impact of imposing new mandatory margin requirements, BBVA considers that new requirements should kick-in in two phases;

- First, only to require the exchange of collateral representing Variation Margin.
- After a prudent period to absorb the effects on liquidity and collateral, then require the additional exchange of Initial Margin.

New margin requirements should apply **only to derivatives entered into after the new regulation** governing margins **is effective**; existing derivatives have been priced based on the terms set up in the CSA agreement between parties; if margin conditions are changed, the economics of current derivative positions will significantly worsen. Entities should not face uncertainty on whether future regulatory changes make unprofitable current and past transactions.

SCOPE - INSTRUMENTS

2. Should foreign exchange swaps and forwards with a maturity of less than a specified tenor such as one month or one year be exempted from margining requirements due to their risk profile, market infrastructure, or other factors? Are there any other arguments to support an exemption for foreign exchange swaps and forwards?

The foreign exchange (FX) market one of the oldest, largest and more liquid markets in the world. It has developed a number of market practices aimed to address the main risks of conducting the FX business; most counterparty risk is managed through extensive use of CSAs while the depth and liquidity of the market allows for quick and efficient closing of counterparty exposures when necessary.

Settlement risk is considered to be the main risk from FX trading activities. With the creation of the Continuous Linked Settlement ("CLS") and the CLS Bank, settlement risk has been eliminated for most major participants. Therefore, adoption of additional risk mitigation provided by the imposition of margining or clearing would not be considered appropriate as existing practices more than adequately address such risks.

In addition, FX derivatives are fundamental for the currency risk management for end-users. Harsh margin requirement on these instruments may reduce the possibility to manage currency risk in an efficient way and make end-users more vulnerable to foreign exchange fluctuations.

After considering all the points together, BBVA believes that FX trades should be exempt from margin requirements.

3. Are there additional specific product exemptions, or criteria for determining such exemptions, that should be considered? How would such exemptions or criteria be consistent with the overall goal of limiting systemic risk and not providing incentives for regulatory arbitrage?

Any other derivative that is broadly utilised by end-users to hedge or mitigate any particular risk-factor should be also exempt in order of not impair their ability to properly manage their risks and, as consequence, increase their vulnerability to price fluctuations.

SCOPE - COVERAGE

4. Is the proposed key principle and proposed requirement for scope of applicability appropriate? Does it appropriately balance the policy goals of reducing systemic risk, promoting central clearing, and limiting liquidity impact? Are there any specific adjustments that would more appropriately balance these goals? Does the proposal pose or exacerbate systemic risks? Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

BBVA agrees with the consensus within the BCBS and IOSCO, expressed in the Consultative Document that margin requirements need not apply to derivatives in which at least one of the parties is a non-financial company that is not systemically important, a sovereign, or a central bank. BBVA understands that the margin requirement should also not apply to transactions in which one of the parties is a SPV that do not qualify as financial entities and transactions pose little or no systemic risk.

Financial institutions already face important capital burdens, with specific charges for their counterparty credit risk (charges that will increase when Basel III kicks in for the new CVA charge and tougher calculations for CCR). This leads to two important points:

- Financial institutions are already incentivised to move derivatives to central clearing as the capital burdens of derivatives cleared through CCPs are much lower than those derivatives cleared bilaterally.
- These institutions are better capitalised with respect to the risks they face compared to CCPs, which typically have thin capital layers and need the support of Initial Margin and default fund contributions to absorb the potential default of a counterparty.

For these reasons, BBVA thinks that **prudently regulated and supervised financial institutions subject to tough capital burdens, with specific charges on counterparty risk, should be fully exempt from the obligation to post Initial Margin** on their non-centrally-cleared derivatives. The exchange of a Variation Margin that covers the full mark-to-market of the derivatives plus tough capital charges on counterparty risk (as in Basel III) should be sufficient to protect prudently regulated and supervised financial institutions' derivatives counterparties, and avoid the imposition of two demanding requirements following separately the same purposes.

5. Are initial margin thresholds an appropriate tool for managing the liquidity impact of the proposed requirements? What level of initial margin threshold(s) would be effective in managing liquidity costs while, at the same time, not resulting in an unacceptable level of systemic risk or inconsistency with central clearing mandates? Is the use of thresholds inconsistent with the underlying goals of the margin requirements? Would the use of thresholds result in a significant amount of regulatory arbitrage or avoidance? If so, are there steps that can be taken to prevent or limit this possibility?

As mentioned in Q4, BBVA considers that an exemption on the obligation to post Initial Margin should apply for regulated and supervised institutions subject to tight capital requirements, with specific capital charges on counterparty risk. **In the case that a full exemption on the obligation to post Initial Margin is not granted for these institutions, thresholds should apply**. The Consultative Document already discusses about the possibility to impose less stringent rules to entities that enjoy some other effective protection against counterparty risk.

BBVA believes that thresholds should respect the following premises:

- **Thresholds should be based on the protection that the entity's regulatory framework offers to its counterparties**; entities subject to different regulatory frameworks (i.e. banking entities vs. insurance companies, banking entities subject to Basel III vs. banking entities subject to Basel II) should be awarded different thresholds, adapted to the degree of protection they offer to counterparties.
- **Thresholds should be expressed as a percentage on the entity capital base**; which is in line with the previous point in the sense that a larger capital base increases protection to counterparties.
- **Thresholds should represent a maximum amount of Initial Margin an entity would not have to post**; entities that offer a larger degree of protection to counterparties will be compensated with an exemption or a reduction on the amount to post.
- **Thresholds should be individually applied for derivatives with each of the entity's counterparty**; this would reduce complexity and increase transparency on the calculations of the collateral amounts to be exchanged between counterparties, and would encourage entities to diversify their counterparty exposure which would ultimately reduce systemic risk.

Thresholds should be high enough to avoid the negative consequences that may arise from the obligation of posting Initial Margin for non-centrally-cleared derivatives, as these regulated entities are already penalised by the capital framework:

- Avoid an excessive penalization to the OTC derivatives market, which would curtail the availability of efficient risk management tools for end-users.
- Reduce the drain of liquidity in the financial system, and the potential problems of scarcity of the eligible collateral.

If exemptions and thresholds do not mitigate the impact of two-way margin requirements, mandatory margining will eventually generate systemic risk with dramatic consequences on the real economy.

6. Is it appropriate for initial margin thresholds to differ across entities that are subject to the requirements? If so, what specific triggers would be used to determine if a smaller or zero threshold should apply to certain parties to a non-centrally-cleared derivative? Would the use of thresholds result in an unlevel playing field among market participants? Should the systemic risk posed by an entity be considered a primary factor? What other factors should also be considered? Can an entity's systemic risk level be meaningfully measured in a transparent fashion? Can systemic risk be measured or proxied by an entity's status in certain regulatory schemes, eg G-SIFIs, or by the level of an entity's non-centrally-cleared derivatives activities? Could data on an entity's derivative activities (eg notional amounts outstanding) be used to effectively determine an entity's systemic risk level?

As mentioned in Q4, BBVA agrees with the consensus within the BCBS and IOSCO that the non-application of the margin requirements for non-financial companies to be restricted to non systemic companies. With the goal of reducing systemic risk in mind, BBVA opposes the idea raised in the Consultative Document (page 9) that margins be only unilaterally collected by certain types of firms (e.g. key market participants). This idea contradicts what we believe to be a basic principle which is that margin requirements should maintain a level playing field among market participants rather than distort it in favour of any specific group; margin requirements for each entity should be proportionally based on the protection its regulatory framework offers to its counterparties; no special treatment should be given any group of market participants. If this principle is not respected, the systemic risk will grow as the derivative markets become more concentrated as a result of the regulatory advantage granted to certain market participants.

7. Is it appropriate to limit the use of initial margin thresholds to entities that are prudentially regulated, ie those that are subject to specific regulatory capital requirements and direct supervision? Are there other entities that should be considered together with prudentially-regulated entities? If so, what are they and on what basis should they be considered together with prudentially-regulated entities?

As mentioned in Q4, BBVA considers that an exemption on the obligation post Initial Margin should apply for regulated and supervised institutions subject to tight capital requirements, with specific capital charges on counterparty risk. In the case that a full exemption is not granted for these institutions, thresholds should apply in the way described in Q5, that:

- Aims to reduce the imposition of two very demanding requirement covering separately the same issue.
- The reduction on the obligation to post Initial Margin is linked to the degree of protection an entity offers to its counterparty.

8. How should thresholds be evaluated and specified? Should thresholds be evaluated relative to the initial margin requirement of an approved internal or third party model or should they be evaluated with respect to simpler and more transparent measures, such as the proposed standardised initial margin amounts?10 Are there other methods for evaluating thresholds that should be considered? If so what are they and how would they work in practice?

From Q5, the percentage of threshold should apply on the posting entity capital base and should be established based of the protection its regulation framework offers to its counterparties.

9. What are the potential practical effects of requiring universal two-way margin on the capital and liquidity position, or the financial health generally, of market participants, such as key market participants, prudentially-regulated entities and non-prudentially regulated entities? How would universal two-way margining alter current market practices and conventions with respect to collateralising credit exposures arising from OTC derivatives? Are there practical or operational issues with respect to universal two-way margining?

High two-way margin requirements may have a devastating effect on the financial system, as it may produce:

- A huge liquidity drag. The industry has estimated on $12-30 trillion of collateral absorption if no exemptions or thresholds are applied. This liquidity drag wil come on top of the new Basel III liquidity ratios that will additionally drain liquidity resources in the banking system.
- A scarcity of eligible collateral and an enormous distortion on its market, due to the large demand these margin requirements would create for these assets.
- A large increase on the cost of non-centrally-cleared derivatives that will impair the availability of efficient risk-management tools for end-users.

Taken together, these may have deep effects on the real economy, and delay the much needed recovery of the economic activity in developed countries.

An exemption on the obligation to post Initial Margin should apply for all institutions that are subject to a regulatory framework that already offers protection to counterparties. Alternatively, thresholds should be large enough to allow these entities to efficiently provide OTC instruments needed by end-users to manage their risks, without being harshly penalised in liquidity and collateral terms. This approach would reduce the possibility of dramatic unintended consequences on the financial system and on the real economy.

10. What are the potential practical effects of requiring regulated entities (such as securities firms or banks) to post initial margin to unregulated counterparties in a non-centrally-cleared derivative transaction? Does this specific requirement reduce, create, or exacerbate systemic risks? Are there any logistical or

operational considerations that would make the proposal problematic or unworkable?

In Q4, we mention that BBVA supports the BCBS and IOSCO consensus on the non-application margin requirements for derivatives transactions in which at least one of the parties is a non-systemic non-financial company, or a SPV.

Regulated entities should only be required to post margin to non-regulated institutions (not exempt from margin requirements) if the latter can handle the collateral collected, it is fully segregated, and it is subject to a jurisdiction that protects collateral and permits the application of netting.

Finally, regulators have to make sure that non-regulated institutions post the accurate amount of collateral required by this regulation. When no regulator can supervise a non-regulated entity compliance with margin requirements, the regulated counterparty should be entitled to calculate the margin it should receive from the non-regulated counterparty.

Regulators should make sure that no mandatory margin is required when the legal framework does not protect collateral and does not recognise the concept of netting.

Regulators should not require mandatory margins until systems to handle all collateral transactions and to manage collateral assets are fully available for market participants.

11. Are the proposed exemptions from the margin requirements for non-financial entities that are not systemically important, sovereigns, and/or central banks appropriate?

In Q4 BBVA supports the not application of margin requirements (collecting and posting) on transactions with non systemically important non-financial institutions and SPVs; margining in transactions with non-financial companies would imply an increase in the cost of the derivatives that may reduce the ability of these companies to manage their business risks appropriately. In addition, non-financial entities might not bear the volatility of the amount to post over time as collateral and might have to borrow money from financial institutions to finance the collateral, which could result in an inefficient use of the lending facilities for these counterparties that would have less disposable credit lines to finance their normal ongoing businesses.

This exemption would also be in line with Dodd-Frank Act and EMIR, which exempts non-financial non systemic companies from mandatory clearing through CCPs.

12. Are there any specific exemptions that would not compromise the goal of reducing systemic risk and promoting central clearing that should be considered? If so, what would be the specific exemptions and why should they be considered?

Intra-group transactions, as discussed in Q25, should be exempted from margin requirements.

MINIMUM AMOUNT AND METHODOLOGY

13. Are the proposed methodologies for calculating initial margin appropriate and practicable? With respect to internal models in particular, are the proposed parameters and prerequisite conditions appropriate? If not, what approach to the calculation of baseline initial margin would be preferable and practicable, and why?

The proposed methodology is based on a 99% confidence interval over a 10 days' horizon, calibrated in a period of financial stress. This is much more stringent than current practices of CCPs, which, unlike prudentially regulated entities, are not subject to tight capital demands, and rely basically on margins and default funds to get protection from potential defaults of counterparties.

BBVA believes that there is no need to set more stringent parameters than in CCPs models to incentivise entities to move derivatives to central clearing; this incentive is already present:

- Regulated entities have to respect high capital charges on counterparty risk (CCR and CVA).
- Central-clearing allows netting of positions across counterparties, while margins in OTC derivatives are only calculated based on the bilateral exposure between counterparties.

BBVA considers appropriate the possibility to use quantitative models in the calculation of Initial Margins, which may produce a more accurate estimation of risks than standardised tables. However, if entities are given the possibility to develop their own internal model, entities may come across with completely different models, especially if, as proposed in the Consultative Document, local regulators would be entitled to approve them. This may give rise to conflicts among counterparties on the amount the have to collect or post each other and may produce arbitrage opportunities across countries or regions. For this reason, BBVA believes **it may be appropriate that regulators provide standardised quantitative models than can be used by entities world wide**. The function of local regulators would be restricted to the approval of the entities that would be allowed to use such model, based on the capability of the entity to handle the quantitative model.

14. Should the model-based initial margin calculations restrict diversification benefits to be operative within broad asset classes and not across such classes as discussed above? If not, what mitigants can be used to effectively deal with the concerns that have been raised?

Netting across asset classes should be treated in the same way that is treated in the methodologies to determine capital requirements; it provides solutions for the netting across asset classes, even for the standardized approach.

Not allowing netting across asset classes represents an excessive punishment to non-centrally-cleared derivatives and is not in line with current practices.

15. With respect to the standardised schedule, are the parameters and methodologies appropriate? Are the initial margin levels prescribed in the proposed standardised schedule appropriately calibrated? Are they appropriately risk sensitive? Are there additional dimensions of risk that could be considered for inclusion in the schedule on a systematic basis?

BBVA believes that the standardized schedule parameters calibration is overly conservative and punitive in comparison to the already very demanding parameters proposed for the quantitative models. There is also an additional burden as netting is not allowed on an asset class level. A fixed percentage measured over a gross notional amount leads to an overestimated margin requirement.

16. Are the proposed methodologies for calculating variation margin appropriate? If not, what approach to the calculation of baseline variation margin would be preferable, and why?

Variation Margin should cover mark-to-market, and recognize netting and diversification benefits for all derivatives subject to a single, legally enforceable netting agreement.

17. With what frequency should variation margin payments be required? Is it acceptable or desirable to allow for less frequent posting of variation margin, subject to a corresponding increase in the assumed close out horizon that is used for the purposes of calculating initial margin?

On a general basis, Variation Margin could be revised on a daily basis, but thresholds should be set for a minimum daily transfer to reduce transaction costs.

Only when derivatives are hard to value or its price is not available on a daily basis Variation Margin should be adjusted in a different frequency.

18. Is the proposed framework for variation margin appropriately calibrated to prevent unintended procyclical effects in conditions of market stress? Are discrete calls for additional initial margin due to “cliff-edge” triggers sufficiently discouraged?

BBVA agrees that a balance has to be reached between the protection from counterparty risk provided by collateral and the stress it may pose in the liquidity management of entities in instances of extreme market movements. Such pressure on liquidity may intensify the stress in the market.

Firms should have the ability to alter (initial and variation) margin practices in response to market conditions and observed levels of volatility in specific instruments or asset classes, without generating pro-cyclical effects.

19. What level of minimum transfer amount effectively mitigates operational risk and burden while not allowing for a significant build-up of uncollateralised exposure?

BBVA considers that a minimum transfer amount of $ 100.000 may be appropriate (in line with the quantity suggested by the CFTC for similar purposes).

ELIGIBLE COLLATERAL

20. Is the scope of proposed eligible collateral appropriate? If not, what alternative approach to eligible collateral would be preferable, and why?

The proposed scope is appropriate when it is to be seen as minimum harmonisation, meaning that all of those assets would have to be seen as eligible collateral and parties have the choice to accept some (and not all) eligible collateral or there should at least be a minimum list. Another preferable approach would be a principle-based approach where BCBS-IOSCO would create principles for maintaining of collateral. These principles would base on the fact that provided collateral can be valued effectively, on a sufficiently frequent basis, and particularly in times of market stress, thus creating a system where the eligible collateral would not have to be based on exact asset classes.

In many circumstances, a broader range of collateral and even outside financial instruments could be used, with the application of the appropriate haircuts. A broader list of eligible collateral would reduce the potential for unintended consequences; the creation of liquidity shortages, the scarcity of eligible collateral and the disruption of the market equilibrium in high-quality liquid assets.

National supervisors should be entitled to expand the list of eligible collateral assets, to accommodate the availability of collateral in the particular the conditions of their own market, but they should not have the possibility to reduce the range of the eligible collateral.

To limit liquidity drain and collateral scarcity, the regulation should not rule on the decision of the assets, inside the entity's eligible asset pool, to use as collateral; this issue should be freely negotiated and set in the bilateral agreement between parties.

Non-financial counterparties are typically liquidity constrained, which makes CSA type of collateral agreements very difficult to enter into if not entirely unrealistic. However, many companies possess highly stable property that could be pledged as collateral instead of cash or other financial instruments.

Financial entities should also be allowed to post less liquid assets for, at least, a portion of its Initial Margin, that could be seen as more stable and less subject to market fluctuations. This would make margin requirements less penalising for banking entities in their efforts to satisfy the liquidity ratios required in Basel III.

21. Should concrete diversification requirements, such as concentration limits, be included as a condition of collateral eligibility? If so, what types of specific requirements would be effective? Are the standardised haircuts prescribed in the proposed standardised haircut schedule sufficiently conservative? Are they appropriately risk sensitive? Are they appropriate in light of their potential

liquidity impact? Are there additional assets that should be considered in the schedule of standardised haircuts?

Any mandatory diversification requirements on collateral would reinforce the threat of unintended consequences; increase the potential scarcity of eligible collateral and deeper disruptions on the market of high-quality liquid assets. Diversification of collateral should be negotiated freely between parties according to their risk management principles.

The standardised haircut schedule seems too conservatives and is higher than the haircuts used by CCPs, and ignores any benefit from diversification and netting.

TREATMENT OF PROVIDED MARGIN

22. Are the proposed requirements with respect to the treatment of provided margin appropriate? If not, what alternative approach would be preferable, and why? Should the margin requirements provide greater specificity with respect to how margin must be protected? Is the proposed key principle and proposed requirement adequate to protect and preserve the utility of margin as a loss mitigants in all cases?

The segregation may be the best way to protect collateral from the potential default of counterparties, but creates new credit risks with third parties. It also leads to a concentration of financial assets in global custodians and CCPs, creating a new systemic risk.

It should not be compulsory to post collateral in jurisdictions in which local laws do not protect collateral and do not respect the concept of netting.

Under current Basel III rules, posting cash collateral to a custodian or a third party that segregates it in its books, would lead to increased exposures and increased risk weighted assets. The requirement to segregate margin for non-cleared transactions would also have a direct impact on the ability of prudentially regulated institutions to manage their implementation of the liquidity coverage ratio (LCR) under Basel III

23. Is the requirement that initial margin be exchanged on a gross, rather than net basis, appropriate? Would the requirement result in large amounts of initial margin being held by a potentially small number of custodian banks and thus creating concentration risk?

Netting is a fundamental concept that is used extensively in financial markets, having the important benefit of reducing exposures in cases where these positions offset each other. Posting collateral on a gross basis, without the benefits of netting, increases the amount of collateral needed in a way not related with existing risks. **Netting should be applied where the legal basis for netting and offsetting exists**.

As mentioned in Q22, segregation increases concentration risks in global custodians; the larger the margin requirements, the higher the concentration risks.

24. Should collateral be allowed to be re-hypothecated or re-used by the collecting party? Are there circumstances and conditions, such as requiring the pledgee to segregate the re-hypothecated assets from its proprietary assets and treating the assets as customer assets, and/or ensuring that the insolvency regime provides the pledger with a first priority claim on the assets that are re-hypothecated in the event of a pledgee's bankruptcy, under which re-hypothecation could be permitted without in any way compromising the full integrity and purpose of the key principle? What would be the systemic risk consequences of allowing re-hypothecation or re-use?

It is important to distinguish between Variation Margin and Initial Margin:

- Variation Margin is the receiver's profit on the trade and the payer has no further claim on it, so it is perfectly appropriate for the receiver to re-hypothecate or re-use Variation Margin.

  It is common practice in the market to allow the re-use of re-hypothecate the collateral received that reflects mark-to-market. If re-use is fully prohibited, there will be a substantial drain of liquidity and a scarcity of eligible collateral that could potentially distort the market for high-quality liquid assets.

- Initial Margin covers potential risk, it will only be property of the collecting party if markets dramatically moves in its favour; it makes sense to segregate Initial Margin and prevent its re-hypothecation.

  Regulation cannot simultaneously require highly liquid and high quality assets as collateral while immobilising the assets possessing these features; it should permit that, at a minimum, a large portion of the Initial Margin to be posted in less liquid assets, even in non-financial assets, with the aim of reducing the liquidity drag in the financial system.

Furthermore, any prohibition on the re-use or re-hypothecation high-quality liquid assets collected as collateral should be delayed until the full impact of the implementation of Basel III liquidity ratios are fully absorbed by the banking system.

TRANSACTIONS WITH AFFILIATES

25. Are the proposed requirements with respect to the treatment of non-centrally-cleared derivatives between affiliated entities appropriate? If not, what alternative approach would be preferable, and why? Would giving local supervisors discretion in determining the initial margin requirements for non-centrally-cleared derivatives between affiliated entities result in international inconsistencies that would lead to regulatory arbitrage and unlevel playing field?

BBVA considers that inter-affiliate derivatives should be excluded from margin requirements, where profits and losses are offset inside the group, and internal risks control measures and risk allocation tools apply at group level. Moreover, derivatives between members of the same group do not pose systemic risk.

Additionally, margin requirements should be in line with other regulation already in place that does not impose any obligation to clear through CCPs, on derivatives between entities belonging to the same group (DFA and EMIR).

26. Should an exchange of variation margin between affiliates within the same national jurisdiction be required? What would be the risk, or other, implications of not requiring such an exchange? Are there any additional benefits or costs to not requiring an exchange of variation margin among affiliates within the same national jurisdiction?

Affiliates in the same country may be supervised by the same local regulators, which can establish measures to reduce the potential systemic risk of each affiliate and the whole group.

CROSS-BORDER TRANSACTIONS

27. Is the proposed approach with respect to the interaction of national regimes in cross-border transactions appropriate? If not, what alternative approach would be preferable, and why?

Global consistency across local jurisdictions is fundamental for the avoidance of regulatory arbitrage.

There should not be any obligation to post collateral subject to a local jurisdiction that does not protect collateral and that does not recognise the concept of netting.

Quantitative models should be quite standardised and available for entities world wide; no local regulator should be entitled to approve any model; their function should be restricted to the approval of the local entities that are allowed to use such models.