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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sir

FIRSTRAND BANK LIMITED'S COMMENTS ON CONSULTATIVE PAPER: MARGIN REQUIREMENTS FOR NON-CENTRALLY-CLEARED DERIVATIVES

FirstRand is grateful for the opportunity to comment on the consultative paper proposing changes to the margin requirements for non-centrally-cleared derivatives. Subject to the comments below and notwithstanding answers to specific questions, FirstRand is broadly supportive of the recommendations and envisaged changes.

The introduction of initial margin for non-centrally-cleared (NCC) derivatives will bring about risk-reducing structural changes to the derivatives market, especially when the OTC market is compared with the centrally cleared market for derivatives. By introducing initial margin for NCC derivatives, the margin practices are effectively equated to the margin requirements a CCP would impose. This then not only reduces systemic leverage in the NCC derivative market (when viewed in aggregate), but also removes a funding disincentive from moving to a central clearing platform. The removal of the funding disincentive then allows for the Basel III capital incentives to operate as intended in inducing derivative trading onto a centrally cleared platform.

In light of the comments above, the calculation of capital and the role played by the posting of initial margin should, in terms of the principles applied, be equivalent in the centrally cleared and non-centrally cleared derivative markets. Specifically, to the extent that initial margin is allowed in the estimation of exposure-at-default (EAD) for centrally cleared derivatives, it should be allowed in the estimation of EAD for NCC derivatives. This would not alter the achievement of the stated objectives of inducing the central clearing of derivatives and the reduction of systemic risk. Rather, it would remove uncertainty and create transparency in the differences between the two markets (OTC and centrally cleared), and allow for more efficient risk management of the counterparty credit risk portfolio.

In the section that follows, please find responses to the specific questions presented. The number of the response corresponds to the number of question in the consultative paper:

1. A phase-in period is desirable. An appropriate phase-in period would need to be assessed once the results of the QIS are complete and the additional funding requirements are understood. The phase-in period can then be calibrated so as not to adversely stress domestic funding and asset markets in a given jurisdiction.

2. The exclusion of foreign exchange swaps of less than one-year can be supported from the view that they can be used as an effective means to raise funding in another currency. To the extent that they are margined, the effectiveness of this funding avenue will diminish. Also, the exclusion of FX forwards of 6 months or less can be supported due to the role they play in managing the currency risk of international trade.

3. Securities financing products such as repurchase agreements or securities lending transactions should be excluded on the basis that they are already effectively fully margined, with an additional haircut. Any other product exemptions should be determined on an *ex post* basis by the national regulator should any unintended negative consequences arise. To that end, national regulators should be given the authority to exclude certain products or instruments to cater for such unintended consequences.

4. FirstRand is supportive of the proposed scope of applicability relating to financial firms. The extension of the scope of applicability to non-financial firms, regardless of systemic importance, is not supported on the basis that the negative funding implications outweigh the credit risk benefit; and secondly, that non-financial firms use derivatives to hedge existing underlying risks with financial firms, i.e. they don't speculate.

5. While banks are in the business of taking credit risk, if the requirement to place initial margin bilaterally is enforced, then that margin should be available in cash or assets and not as a credit line (i.e. threshold). Additionally, the application of initial margin thresholds presents significant challenges. The framework establishing the thresholds, operational management of margin placements/calls, and the operational burden of monitoring compliance with these thresholds renders the benefit greatly reduced.

6. See response to question 5.

7. See response to question 5.

8. See response to question 5.

9. FirstRand is of the view that it will be challenging from an operational, legal, and IT systems perspective to implement an initial margin regime for non-cleared derivatives. The proposed QIS will be revealing as to the financial cost to banks to implement the regime from a capital and funding perspective.

   FirstRand is also of the view that a significant unintended consequence of these proposals would be to reduce the trading liquidity of non-cleared derivatives significantly.

10. FirstRand is of the view that the requirement for regulated entities to post initial margin to non-regulated entities will exacerbate systemic risk.

11. Yes, the exemptions are appropriate.

12. No additional exemptions are proposed.

13. FirstRand is supportive of the proposed methodologies for calculating initial margin, as well as the proposed parameters and prerequisite conditions. Specifically, FirstRand supports initial margin models accounting for risk on a portfolio basis, where the portfolio includes trades subject to a single, legally enforceable netting agreement. Presumably then the bilateral initial margin will be adjusted by the incremental impact of each new trade to the potential future exposure of the portfolio.

    It is noted here that, notwithstanding the above, there are likely to be significant constraints to agreeing the potential future exposure of a portfolio, particularly given the idiosyncrasies present when counterparts use proprietary internal models. This, no doubt, contributed to the requirement for robust dispute resolution procedures being in place. Having said that, banks will still find it challenging to implement the initial margin regime operationally given that there will be many modelling idiosyncrasies to overcome with many counterparts.

14. Diversification benefit should be limited across asset classes. However, if a supervisory approved model is being used, there should be no restriction on the empirical diversification benefit within asset classes.

15. FirstRand supports the margin parameters contained in appendix A.

16. FirstRand is supportive of the proposed variation margin calculations, particularly the requirement around the low minimum transfer amount.

17. Variation margin should be transferred daily, in line with current market practice, and de-linked from any assessment of the assumed close-out horizon in the initial margin calculation

18. While large, discrete margin calls are appropriately discouraged, they may not be possible to avoid. Large margin calls will be a function of the instability of the diversification benefit of the portfolio, particularly when new derivative positions are added or existing positions mature. Specific positions that either introduce or remove significant diversification could have a large impact on the replacement value and potential future exposure of a portfolio

19. No response

20. FirstRand supports the proposed list of eligible collateral

21. FirstRand is of the view that it is highly desirable to implement concentration limits for the placement of asset collateral. The proposed haircuts are appropriate for instances where there are sharp price moves but market depth and liquidity are maintained. Due to the fact that concentration and liquidity become negatively mutually reinforcing, it is simpler to limit concentration than to adjust asset haircuts. To that end, FirstRand proposes that for bonds,

limits are applied in terms of maturity and percentage of total issue allowed to be placed or received. For equities, limits as to the percentage of market cap should be applied. These limits should apply per counterpart because the requirement to make use of margin is contingent on a counterparty defaulting.

22. The national regulator should be given discretion to determine the most appropriate treatment of provided margin given the unique insolvency laws in each jurisdiction.

23. FirstRand is supportive of the proposal that initial margin should be exchanged on a gross basis. The operational challenges mentioned above should be noted in this regard.

24. FirstRand is of the view that collateral should not be allowed to be re-hypothecated. If it were allowed, it would exacerbate rather than mitigate systemic risk.

25. FirstRand is supportive of the BCBS and IOSCO compromise that variation margin is transferred between affiliates and not initial margin

26. See response to question 25.

We appreciate the opportunity to comment on the consultative document in respect of margin requirements for non-centrally-cleared derivatives.

Please contact us, should you have any questions on our views expressed in this letter.

Yours sincerely

YVETTE SINGH
PUBLIC POLICY AND REGULATORY
AFFAIRS EXECUTIVE