HSBC

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

International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid
Spain

26th September 2012

Dear Sirs

CONSULTATIVE DOCUMENT – MARGIN REQUIREMENTS FOR NON-CENTRALLY-CLEARED DERIVATIVES

HSBC was involved in responses by ISDA, IBFed, Cleary Gottlieb, ABA and others and support these responses.

HSBC supports the objective of reducing systemic risk, and wants to operate in safe markets. Market participants have at their disposal a set of tools to reduce systemic risk, such as central clearing, appropriate capital levels to absorb losses, margin and others. They should be allowed to use all tools in the toolbox in the most efficient fashion.

Being an international financial services group which has a number of banking subsidiaries and clients in many regulatory jurisdictions, we would like to raise concerns that arise from our particular situation and structure. These are detailed in the attached response. Our main points are that:

- Universal bilateral IM would use more liquidity than firms will be able to source or afford. Even if the required amount of funds could be sourced it would make uncleared OTC transactions unaffordable for our clients. They would end up with unhedged risks, making their products or debt more expensive or causing smaller pension or savings returns.

- Most OTC derivatives will be cleared, but not all products will be sufficiently standardized or liquid to be centrally cleared safely. Even so these products should be able to play an important role in hedging risk for our clients and should not be discouraged.

- Variation margin (VM) should always be exchanged, but only systemically important institutions should collect IM. Counterparties should be allowed to apply bilaterally negotiated IM thresholds to suit their cash flow and credit position.

- The proposed rules will increase risk in jurisdictions where netting is not enforceable. As an international bank HSBC has many customers in these jurisdictions, and would like to see a safe framework to transact OTC derivatives with these customers.

We would be happy to discuss these further in detail with your representatives.

Yours faithfully

Jose-Luis Guerrero
Co-Head Global Markets

HSBC Bank
Global Banking and Markets
Level 4, 8 Canada Square, London E14 5HQ
Tel: 020-7991 8888

BCBS226: Margin requirements for non-centrally-cleared derivatives

HSBC Response

Date: 21/09/2012

Public

General Remarks

HSBC supports the objective of reducing systemic risk, and wants to operate in safe markets. Market participants have at their disposal a set of tools to reduce systemic risk, such as central clearing, appropriate capital levels to absorb losses, margin and others. They should be allowed to use all tools in the toolbox in the most efficient fashion.

Universal bilateral posting of initial margin (IM) will require a huge amount of collateral across the market, and such an approach to eliminate counterparty credit risk at all costs will not be efficient and will not necessarily reduce systemic risk.

These levels of liquidity that need to be funded will make OTC derivatives that are not centrally cleared prohibitively expensive, and our clients might decide to stop hedging some of their risks. Some products might not be liquid or standardized enough to be safely cleared at a CCP, but nevertheless are helpful tools for our clients to hedge their risk and important for the "real economy", e.g.

- Options on less liquid underlyings or currencies
- Illiquid single name CDS (whose use is incentivized by Basel III)
- Interest rate Swaps that cannot be cleared because they have nonstandard features to exactly match them with the pay-off of a bond portfolio of a fund manager

We are also worried about the side effects to the economy if such a huge amount of liquidity is locked into segregated margin accounts.

To mitigate all these effects, we suggest applying exchange of IM only where it has clear advantages, i.e. protection of systemically important counterparties by mandating them to collect initial margin. Similar to the rules suggested by CFTC, we propose not to require non-systemically important entities to collect IM. These counterparties would not affect the financial system if they defaulted, and therefore should have the choice (and transparency over the resultant cost) whether to negotiate bilateral margin with their counterparties or not.

We also suggest that firms should be allowed to define their risk appetite and to extend credit to their counterparties by setting thresholds depending on their view of the credit quality of the counterparty and their risk appetite. Margin above this threshold would then be available to cover the tail risk for events that increase the exposure above these defined levels.

We also note that prudentially regulated firms hold capital against counterparty credit risk that is available to absorb losses, or to bridge a period that is needed to liquidate collateral. Exchanging margin reduces the current and/or potential future exposure and therefore the capital requirements for a portfolio of transactions. The Basel capital models take the exposure and credit quality of counterparties into account, and firms should have some discretion whether they want to hold capital against an exposure or to collect initial margin. Basel 3 has strengthened the counterparty risk capital framework considerably, through means such as stressed calibration of models, the CVA capital charge for volatility in CVA, the increased asset value correlation for financial entities to name just a few.

We also note that whilst IM can be used to cover only the default of the counterparty posting that margin, capital is available to cover losses from any counterparty which defaults, and therefore is a more efficient use of funds. Regulation should – whilst reducing systemic risk in the market – be flexible enough to allow firms to find a mix between IM and capital that delivers the most efficient use of resources to manage risk.

The paper states as one of two main objectives the promotion of central clearing. Whilst central clearing is a useful tool to reduce credit risk for standardised derivatives, it is not the panacea for risk. For less standardised and liquid transactions which are difficult to risk manage in a CCP, the use of central clearing might actually increase risk. Therefore there will always be products that cannot and should not be cleared, and consequently there should be no incentive to push these into central clearing.

In this consultation paper it is not always clear which rules apply to IM and which to VM. For instance, whilst bilateral IM should be segregated and cannot be rehypothecated; the posting party has no further claim to VM, which is usually used to fund opposite MtM movements for hedges, therefore VM should be allowed to be rehypothecated and to flow freely through the system.

To avoid uncertainty, these rules should not be applicable retrospectively to existing transactions, unless counterparties so chose. Retrospective application can make existing trades uneconomic, and can be impossible if counterparties from jurisdictions not subject to mandatory exchange of margin for un-cleared transactions are

involved, particularly counterparties from non-netting jurisdictions. Also, counterparties do not have enough clarity about the rules to price in the impact of collateralization before the rules are known.

Finally, it is of paramount importance that these rules are implemented globally on a consistent basis, and we suggest the Standards Implementation Group to be involved in the review of the detailed implementation of these rules world-wide.

Issues not covered in the consultation

The IMM shortcut method – calculating the exposure as the max of current exposure and thresholds + MTA plus a VaR based add-on for potential future exposure - allows application of collateral only for the current exposure and not the potential future exposure. This method works well for exposures covered by only VM, but not when IM is exchanged widely.

We also need clarification whether these rules will affect the leg between clearing client and clearing member for a centrally cleared client transaction. According to BCBS227 this leg is to be treated as an OTC derivative. Clarification is sought that this leg is treated as an OTC derivative only for capital purposes, but does not mean bilateral IM is mandated.

Implementation and timing of margin requirements

Q1. 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?

- From a practical point of view, the industry has to overcome sizeable challenges:
  - Building the infrastructure for segregated posting of margin. Given the widespread exchange of IM envisaged by regulators, these need to be automated processes, and industry needs to develop standards for enabling straight-through-processing of collateral movements, pledges and releases of these pledges.
  - There is the possibility that bankruptcy laws need to be updated to reduce legal risk in these arrangements.
  - Updating of documentation – large banks have thousands of counterparties, all of which would need updated netting and collateral agreements. There is little chance of timely implementation without updated industry standardised documents that are quicker and easier to negotiate than a current ISDA agreement.
  - Sourcing of the needed margin at a time when industry also needs to increase capital ratios and comply with Basel III liquidity and funding requirements. We suggest that margin phased in gradually, by counterparty category and IM amounts to be called according to the rules (e.g. at the beginning only category A firms as defined in the QIS with exposures greater than 50m should be subject to the rules). This would help both reduce the liquidity impact and the operational burden of renegotiating thousands of CSA contracts. Our QIS result show that if counterparties are segmented by IM amount the number of affected counterparties and therefore the impact of re-documentation becomes easier to manage:

IM Level	Percentage of counterparties with non-zero initial margin after application of thresholds but without allowing for diversification/ netting across multiple asset classes
EUR0 million	**100%**
EUR0.5 million	**35%**
EUR1 million	**25%**
EUR5 million	**9%**
EUR10 million	**6%**
EUR25 million	**3%**
EUR50 million	**1%**

  - Working with regulators to review and gain approval for margining models covering the majority of non-cleared exposures so that a level playing field is maintained. Judging by current workload of regulators, this

will be a lengthy process, and transitional rules are needed (e.g. allowing IM models until regulators have finished their approval process of a firm's model)

- These issues take time to solve, and should be taken into account in the implementation timeframe of these rules. We believe that implementation before 2015 is unrealistic. Implementation could be phased by counterparty types (in addition to phased in liquidity levels) to give market participants with lesser abilities to post collateral more time for implementation.
- In terms of co-ordination with other initiatives: Margining of un-cleared transactions should not be mandated before clearing mandates and the build-up of the clearing infrastructure for the whole market (i.e. client clearing for all instruments and on-boarding of the majority of the market participants). Otherwise many market participants would be forced to exchange bilateral IM for standardized transactions that will later be novated to clearing. For this intermediate period liquidity requirements would increase considerably before these transactions can be novated.
- To avoid uncertainty, these rules should not be applicable retrospectively to existing transactions, unless counterparties so chose. Retrospective application can make existing trades uneconomic, and can be impossible if counterparties from jurisdictions not subject to mandatory exchange of margin for un-cleared transactions are involved and reject to exchange IM retrospectively. Also, counterparties do not have enough clarity about the future rules to price in the impact of retrospective collateralization.

Scope of coverage – instruments subject to the requirements

Q2. 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?

- Exemption of FX transactions should be in line with the US to avoid an un-level playing field. We note that there are discussions in the US whether NDF should be exempt from the definition of a swap.
- Settlement risk dwarfs all other risks in the FX market, based on an Oliver Wyman analysis. This illustrates that settlement risk comprises 94% of the estimated maximum loss exposure in a transaction involving foreign exchange instruments with a maturity of 6 months and 89% for instruments with a maturity of 2 years.
- Following extensive study of systemic risk, central banks and FX dealers went to considerable lengths to address this risk, ultimately leading to the creation of CLS Bank as a global settlement bank. CLS Bank's settlement system today eliminates virtually all settlement risk to CLS Bank participants. CLS Bank settles almost 90% of all inter-dealer FX trades. Efforts to extend the reach of CLS Bank are under way, with broad support from FX dealers and central banks around the globe. To address the remaining mark-to-market credit risk, credit support annexes ("CSAs") are heavily used and relied on in the FX market and are a particularly effective risk mitigation tool. Initial analysis by the Global FX Division estimates that 85% of the mark-to-market credit risk for FX swaps and FX forwards is effectively covered by CSAs. Even for 2-year instruments, only 1.65% of the credit risk of loss in FX instruments is not covered by CSAs (with 0.9% not covered by CSAs for instruments with maturities of 6 months). Mandatory clearing for FX swaps and FX forwards would therefore deliver almost no incremental credit risk mitigation. We believe that the significant operational risk and costs to the global payment system of implementing mandatory clearing far exceed the benefits of mitigation for the small residual unsecured credit risk of FX swaps and FX forwards.
- The FX market performed well throughout the last crisis, and previous ones, handling multiple defaults including Lehman without a drying-up of liquidity or material losses.
- Any tenor-based margin requirement would encourage avoidance by trading just below the threshold, leading to increased roll and settlement risk.

Q3. 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?

- Products than can be liquidated or hedged easily, for instance equity swaps (Total Return Swaps, CFDs) on main index names and/or indices, should be exempt, potentially subject to a cap on size vs. average trading volume.

Scope of coverage – scope of applicability

Q4. 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?

- As stated above, central clearing should not be promoted at any cost. Regulators will identify products that are sufficiently liquid and standardised and mandate these products for central clearing. All other products will be then by definition be unsuitable for central clearing and consequently there should not be any incentive to clear these products as they are better dealt with outside of CCPs.
- Regulators should understand that the proposal is effectively an exchange of counterparty risk and capital requirement for liquidity and operational risk. The effect and cost of bilateral margining on liquidity has not yet been properly assessed. It is very likely to interact with resolution planning and will be another drain on the total borrowing capacity of the market.
- Depending on calibration, the resulting liquidity impact of mandatory bilateral margining of un-cleared transactions might pose systemic risk. Despite the fact that the liquidity impact is not understood by any market participants including regulators, rules are now established that force the market to exchange IM. Some participants will struggle to find the required collateral and either borrow the needed funds, or ask banks to transform lesser quality collateral into collateral that complies with the rules. Neither outcome would reduce risk in the system, but would only move risk around and make it less transparent, in extremis even move it to the shadow banking system.

Senior Bonds

Year	Total Amount Issued (USDm)	No. of Issues	Total HSBC (USDm)	No. of Issues	Market share (%)
2007	2,265,057	2,427	10,093	9	0.45%
2008	2,185,144	2,026	4,508	7	0.21%
2009	3,099,431	2,838	12,196	14	0.39%
2010	2,934,792	3,374	12,567	12	0.43%
2011	2,712,642	2,927	19,136	15	0.71%
2012 ytd	2,303,074	2,611	5,994	8	0.26%

Covered Bonds

Year	Total Amount Issued (USDm)	No. of Issues	Total HSBC (USDm)	No. of Issues	Market share (%)
2007	296,072	282	0	0	0.00%
2008	231,898	253	0	0	0.00%
2009	223,245	259	0	0	0.00%
2010	296,361	289	2,162	1	0.73%
2011	336,121	292	1,250	1	0.37%
2012 ytd	181,361	160	0	0	0.00%

Source:	Dealogic
Criteria:	Senior [Covered]
	Ranking Eligible trades
	Minimum deal size $250m equivalent
	Not Subordinated
	Euro, Sterling or US Dollar denominated
	Not ABS, preference shares, short term debt or money markets

- The table above shows funding by industry over the last years. WGMR will by now have visibility over the QIS results and be able to compare the funding of global banks with the overall margin requirements as suggested by this consultation paper. The estimate of HSBC's IM requirements is considerably higher than the funding even in 2011, the year with the most funding in the last years. Banks could be able to increase their funding slightly, but not up to levels required by these proposals.
- The key principle that margin should be "appropriate to the risks posed by such transactions" indicates a measure of risk sensitivity that is not captured in the following details of this consultation paper, e.g. the universal exchange of bilateral IM with standardised thresholds.
- Unlike CCPs, banks do have capital to absorb losses. Banks usually expect a small fraction of exposures (be it loans or derivatives exposures) to be lost due to default and adapt their pricing and capital levels appropriately. This is not in question for lending exposures, but for derivatives transactions regulators seem to want to eradicate losses due to default at nearly any cost. Banks have the capability to review the risk attached to their counterparties and will continue using internal models and their own judgment for banking book transactions. However recent regulatory developments, especially the CVA capital charge and margining of un-cleared transactions incentivise banks to use mechanistic & simplistic models in the trading book instead of careful consideration of the counterparties to whom they wish to extend credit and the amount thereof. In our opinion this is not a good way forward to more stability and lending.
- A "defaulter pays" regime not only erodes the incentive banks have to practice good "underwriting" of counterparty risk in the trading book, it also ignores that the risk of a portfolio is less than the sum of its parts – capital should scale in a manner that reflects the risk contribution of each part to the whole in stressed conditions even if it is not specifically allocated to any one client's risk; margin on the other hand is specific to each client for their protection and additive across client. The amount of margin held in aggregate will greatly outstrip the amount the bank could lose; the cost of this inefficiency will be borne by clients.
- Addressing the issue of systematic risk through margin requirements will not necessarily solve the problem and is wasteful in an economic sense because it ignores risk diversification effects that is observable even in crises.
- Basel III has strengthened the capital framework for counterparty risk considerably, and we do not share the belief that capital levels in stressed condition might not be appropriate. Au contraire, the combination of the strengthened Basel III framework together with universal exchange of zero threshold variation margin between covered entities would be a very strong safeguard against systemic risk. In such a framework many cases of overtrading (e.g. by AIG) would not have happened, or would have been caught in an earlier stage of the crisis when these entities could have reduced their risk at an affordable price.
- However, if the regulators do not feel that capital captures adequately the systematic risk posed to each institution by others, then perhaps an alternative would be to put in place more stringent capital adequacy tests focused on the ability of banks and other systematically important entities to withstand the default of one or more of its most significant trading counterparties.
- Addressing systematic risk through Pillar II of the current regime would obviate the need for an expensive and time-consuming overhaul of banks' systems, processes and legal agreements to support. Those banks with insufficient capital to withstand such events would as a consequence be incentivised to manage their exposure appropriately through a number of means including: raising capital buffers, reducing concentration, promoting diversification, tightening collateral arrangements, and increasing margin requirements.
- We suggest restricting the effective but expensive tool of mandatory bilateral exchange of segregated IM to systemically important market players, similar to that proposed by the CFTC. Systemically important entities with high risk of contagion (along a definition like swap dealers) should be protected by the requirement to collect IM. Counterparties not falling under this definition however should not be required to collect IM – should they default due to a counterparty default the impact on the financial system would be contained. Obviously all counterparties have the choice of negotiating arrangements beyond this suggestion – we don't suggest that non-systemically important clients are not entitled to protection, but that they should have the choice to negotiate with their counterparties what level of protection they require and that they have transparency about the cost involved.
- From a practical point of view, the industry has to overcome sizeable challenges:
  - Building the infrastructure for segregated posting of margin. Given the widespread exchange of IM envisaged by regulators, these need to be automated processes, and industry needs to develop standards for enabling straight-through-processing of collateral movements, pledges and releases of these pledges.
  - There is the possibility that bankruptcy laws need to be updated to reduce legal risk in these arrangements.

- Updating of documentation – large banks have thousands of counterparties, all of which would need updated netting and collateral agreements. There is little chance of timely implementation without updated industry standardised documents that are quicker and easier to negotiate than a current ISDA agreement
- Sourcing of the needed margin at a time when industry also needs to increase capital ratios and comply with Basel III liquidity and funding requirements. We suggest that margin phased in gradually, by counterparty category and IM amounts to be called according to the rules (e.g. at the beginning only category A firms as defined in the QIS with exposures greater than 50m should be subject to the rules).
- Working with regulators to review and gain approval for margining models covering majority of non-cleared exposures so that a level playing field is maintained. Judging by current workload of regulators, this will be a lengthy process, and transitional rules are needed (e.g. allowing IM models until regulators have finished their approval process of a firm's model)
- Documentation cross border and for non-netting jurisdictions have to be clarified;
- These processes just are not yet in place to any material degree in respect of OTC bilaterally cleared derivatives.

- Segregated IM would almost certainly be held by a small number of large custodian banks, which would introduce a new element of systemic risk. Requiring all participants to exchange bilateral IM would increase this risk dramatically.
- Capital rules require clearing members to treat the leg of a cleared transaction between clearing client and clearing member as an OTC transaction. These rules should clarify that these legs of cleared transactions are not OTC derivatives where bilateral margining is applicable.

Q5. 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?

- IM thresholds can be a good tool to reduce the liquidity impact of IM.
- The major shortcoming of IM thresholds as suggested in the paper is that they don't take counterparty quality into account. Two counterparties of a firm with similar large exposures might warrant completely different levels of IM due to the credit quality of these counterparties. Banks usually have credit officers who analyse their counterparties in detail in order to establish how much credit to extend to them. Second-guessing this effort by a broad-brush rule will be counterproductive, resulting in some counterparties having to post more collateral than needed, while others do not post enough.
- To reduce the liquidity impact, we suggest the use of thresholds to be negotiated by both sides (if both counterparties are required to collect IM). One of a basic functions of a bank is to extend credit, be that via a loan or via a derivatives line. Allowing firms to determine or negotiate an IM threshold for a client that depends on the risk appetite of a firm would reduce the liquidity impact to their counterparties (which are often buy-side firms whose assets are not liquid enough to be used as collateral), whilst reducing the tail risk by collateralising all exposures above the agreed threshold. These thresholds could be made subject to transaction reporting, so that regulators get a good picture of the maximum credit extended in the market
- The consultation paper argues that "margin can be seen as offering enhanced protection against counterparty credit risk where it is effectively implemented". We however see capital as an important tool in providing the ability to absorb losses to the system.
- The fact that capital is not linked to one particular exposure, but the whole portfolio makes the use of capital much more efficient and risk sensitive than applying IM.
- Allowing IM thresholds would combine the use of IM and capital in a very efficient way:
  - Capital would cover exposures under the threshold, i.e. the defined risk appetite
  - VM and IM would cover the tail risk, i.e. the risk of adverse movements in the market that causes the exposures to grow over and above of the thresholds.

- Basel 3 has strengthened the capital framework of banks considerably:
  - Capital ratios will increase considerably under Basel 3, and even more so for systemically important counterparties. For the same risk weighted assets (which will be higher as before, see below) firms will need to hold more much capital than now.
  - Exposures will be calculated using stressed calibration of the EPE models, taking stressed conditions already into account
  - The CVA capital charge adds a large capital buffer to cover the change of counterparty quality. Incentivising banks to hedge their exposure to counterparties with CDS provides another way to mitigate the systemic effects of a counterparty default. Mandating universal IM without thresholds would reduce all incentives to use credit protection.
  - The increased Asset Value Correlation will be increased for financial counterparties, therefore taking the increased correlation of such counterparties during stressed periods into account
  - Large netting sets, illiquid exposure or collateral and margin disputes will lead to a longer margin period of risk and increased exposures
  - Basel 3 mandates higher exposure for wrong-way risk
- All these measures make capital a prudent and very risk sensitive tool to absorb losses. IM however does not take counterparty quality into account at all – exposures to good quality counterparties are protected exactly the same as exposure to near-default counterparties.
- On top of this, competent authorities already have a tool in pillar 2 of Basel which allows for systematically important institutions being asked to prove to them that they are sufficiently capitalised to withstand the failure of their N largest counterparties, combined with the market events (and contagion) that might follow such an event. Such questions are asked of CCPs for much the same reason. This should be a better way than implementing universal mandatory exchange of IM to address concerns that capital might not be sufficient in stressed market environments.

Q6.	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?

- We do not believe that standardised thresholds that fail to account for credit quality are an efficient use of liquidity.
- To further reduce the liquidity impact, we suggest the use of thresholds to be negotiated by both sides. One of the basic functions of a bank is to extend credit, be that via a loan or via a derivatives line. Allowing banks to set a threshold to a client that depends on the bank's risk appetite would reduce the liquidity impact to their counterparties (which are often buy-side firms whose assets are not liquid enough to be used as collateral), whilst reducing the tail risk by collateralising all exposures above the agreed threshold. These thresholds could be made subject to transaction reporting, so that regulators get a good picture of the maximum credit extended in the market. Please see the answer to question 7 for more detail.
- When defining systemically important entities, regulators should not solely rely on nominal amounts as these are absolutely not indicative of risk and are a poor measure. A better measure would be overall risk weighted assets (RWA). However definition of these counterparties could be left to national regulators and in the US for instance follow the swap dealer and major swap participant classification.

Q7. 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?

- We support that prudentially regulated firms should be allowed to set thresholds based on risk appetite and credit quality of the counterparty, and are therefore able to balance liquidity and capital requirements, and to fulfill their function of extending credit to the market. Were those prudentially regulated firms, which include all systemic important banks, then required to post IM to non-systemic important counterparties, liquidity requirements would increase for a questionable reduction of systemic risk. (see questions above for more detail)
- Transactions between two systemic counterparties should be covered by IM. These counterparties should be allowed to negotiate thresholds, which do not necessarily need to be symmetrical, depending on differing credit quality.

Q8. 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?

- Neither absolute thresholds nor thresholds relative to the size of overall margin would take credit quality of counterparties into account.
- The regulatory capital regime already provides a guide to banks as to which counterparties should have higher and lower thresholds: exposure not covered by initial margin will need to be covered by capital and the capital charge will be higher if the counterparty is lower-rated than if it is higher-rated. As such the capital regime promotes lower thresholds for both large exposures and poorer credits. It should be left to banks to operate within this regime and set thresholds in a way that optimises capital consumption for the revenue opportunity each relationship provides.

Q9. 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?

- Please see question 4 for a comparison of margin requirements to global bank funding. This shows clearly how large the margin requirements will be in comparison to current bank funding. This funding cannot be increase by multiples without considerable cost impacts.
- Consequences will likely be
  - Higher cost, reduced volumes and liquidity of instruments that cannot be cleared, making it more challenging for market participants to manage the risk of these positions.
  - Bespoke derivatives that are ideal matches to complex risks the buy-side wishes to mitigate will become more expensive and might become unaffordable, forcing clients to use standardized instruments and accept increased basis risk.
  - Unknown side-effects in the real economy if OTC market participant drive up the price of funding, and also drive up the price of assets that can be used as segregated collateral.
  - Scarity of eligible collateral, including increased use of collateral transformation and margin lending
  - Increased leverage of both banks and non-banks
  - Operational challenges: the tri-partite clearing market at present is not geared up to high volumes and straight-through-processing
  - Significant systems spend will be required up-front to monitor and manage collateral held at third parties and the cost of managing this collateral on an on-going basis will rise.

- Increased concentration of collateral at a small number of tri-partite providers: an operational failure or fraud at one of these institutions would have broad systematic implications.
- Universal two way margining will increase the level of operational risk with significant amount of cash and non-cash margin transferring ownership and/or pledge accounting each business day.
- A lawyer bonanza: thousands of netting and collateral documents would have to be re-negotiated
- Disputes will likely increase and will put pressure on infrastructure potentially taking longer to resolve.

Q10. 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?

- Prudentially regulated firms should be allowed to set thresholds based on risk appetite and credit quality of the counterparty, and therefore being able to balance liquidity requirements with capital requirements and to fulfill their function of extending credit to the market. Were those prudentially regulated firms, which include systemic important banks, then required to post IM to non-systemic important counterparties, liquidity requirements would increase for a questionable reduction of systemic risk. We advocate a model in line with CFTC's draft rules mandating only systemic counterparties to collect IM, which would reduce the liquidity impact and operational burden of exchanging bilateral IM.
- Unregulated counterparties rely on prime brokers and custodians to administer margin flows. The technical and legal capabilities of custodians & sub-custodians varies considerably. There are few robust credible solutions leading to potential concentration risk. The costs of segregation will encourage buy-side participants to concentrate their non-cleared business with one or a very small number of banks. This might have the perverse effect of increasing their systemic importance as the impact of their default would be concentrated; but it would also give the bank(s) a more complete picture of the buy-side participant's portfolio risks.
- While many regulated entities already have the infrastructure to collect IM, few non-regulated market participants have this infrastructure. Developing it will be costly as will be operating it, for little if any systemic benefit.

Q11. Are the proposed exemptions from the margin requirements for non-financial entities that are not systemically important, sovereigns, and/or central banks appropriate?

- We welcome exemption of corporate non-systemic entities, in line with exemptions from clearing. Every dollar that these corporate entities need to post as margin cannot be used to produce goods, and would be taken from the real economy.
- As with other types of counterparties, we feel that it should be left to banks to operate within the regulatory capital regime and rely on their credit analyst's expertise to determine whether a non-financial entity, sovereign or central bank is sufficiently creditworthy to justify not being charged initial margin. In many cases, this will be true, but it is preferable that the regulations are not constructed in such a way that prevents banks from reacting to changing conditions and managing its risk effectively.
- The range of SPVs which form a large portion of "shadow banking" frequently have been structured with no spare assets from which to procure borrowing or assets to put up as IM. It is critical for regulators to consider whether these should be grandfathered, or whether, for example in the case of covered bond vehicles, they should be exempted.
- Whilst not material, we also suggest exempting private investors from any requirement to collect IM.

Q12. 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?

- See above – the obligation to collect initial margin should be waived for participants which are not systemically important. By definition they will not spread contagion if they suffer a loss or even default themselves as a result of a counterparty default. For example, a small hedge fund may find the administrative burden of collecting

margin from its only bank counterparty onerous; should the bank default then even if it causes the fund to collapse there is no systemic contagion.

Baseline minimum amounts and methodologies for initial and variation margin

Q13. 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?

- Exchange of initial margin boils down to an exchange of credit risk with liquidity requirements/risk. The more conservative initial margin is calibrated, the higher the required liquidity, and the underlying transactions might become unaffordable, effectively avoiding default losses at any price. This might have been a good outcome for transactions with monolines, but not necessarily so with pension funds, insurances and asset managers, making the products these companies sell to the public more expensive or more risky.
- Regulators already have bandwidth problems approving existing models (market and counterparty risk). The ability of regulators and effort to review and approve more sophisticated models was used as a reason not to allow CCPs to use IMM for the calculation of hypothetical capital. We doubt if there is bandwidth to review margin models in the level of detail envisaged by the consultation paper. We welcome the use of internal models, and suggest aligning the requirements for margin models as much with existing market and credit risk models as possible to exploit synergies in supervision of the models.
- There also need to be transitional arrangements, e.g. that firms are allowed to use their models until the approval process has been completed.
- The aim of using internal models is not solely to lower margins, but to use appropriate risk-sensitive assessments of potential future exposure. Given that risk insensitive standardised models will in most cases be more conservative than models that measure risk appropriately, we don't see lower margin requirements calculated by a model and appropriate assessment of the potential future exposure to be a contradiction. After all, there need to be some incentives for the development of models.
- A scenario under which firms use the same VaR model or calibrate to the same periods could be considered pro-cyclical. As such, there would be benefit in allowing participants to use a variety of modeling techniques, including stress-based and rule-based approaches, provided that banks are able to demonstrate that certain minimum standards (eg backtesting) are met. Furthermore, banks must be permitted to apply such models across asset classes - particularly between FX and other asset classes, but also between cleared and non-cleared instruments - if they can demonstrate that the consideration of cross-asset risk is appropriate and conservative.
- Banks should be permitted to model jointly the exposure and the collateral, e.g. swap exposures covered by government bonds; equity derivative exposures covered by equities, but also between asset classes. This would allow wrong-way risks to be accounted for explicitly and recognise diversification between the exposure and the collateral.
- We also suggest that single name credit protection of a counterparty portfolio (for instance bought to mitigate the CVA capital charge) can be deducted from the IM amount resulting from the model.
- For operational simplicity, we read "Initial margin should be collected *at the outset* of a transaction" to mean t+1 payment as with other collateral. Requiring same day movement of collateral for all market participants would be an unrealistic endeavour.
- With IM the scope for disputes increases dramatically – not only the current exposure (one set of valuations) could be disputed, but several sets of valuations, historical scenarios and other model inputs and assumptions might lead to different results. Industry needs robust dispute management procedures for IM. One mitigant would be for the counterparties to agree the use of a third party calculation agent.
- Given that models will most likely calculate more risk sensitive and usually more efficient margin levels, participants without their own margin models should on a consistent basis be able to elect to use the margin calculation of their counterparties who have approved models. Consistent basis means that should a participant elect to use its counterparty's models, it must do so going forward until the exposure is zero, i.e. not to cherry-pick from day to day between modeled margin and standardised margin.

Q14. 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?

- Given the high impact on liquidity, and the ability to take netting benefits between asset classes if the counterparty defaults, we think disallowing netting between asset classes to be overly conservative. Whilst in a crisis correlations might break down, or become considerably higher than in benign markets, the requirement to use historical data that contain the most stressed periods will already introduce conservative levels of correlations assumptions in the model.
- Recognition at least must be given to offset between FX transactions and FX risk embedded in transactions in other asset classes otherwise the incentive to hedge FX exposures will be eroded through increased hedging costs.
- Another way to reduce the liquidity impact would be to allow cross-product margining, i.e. collecting from clients initial margin that covers cleared and un-cleared transactions including the netting benefit between those, but not necessarily between asset classes.

Q15. 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?

- We feel that the standardised margin percentages are overly conservative. What is suggested is effectively CEM with higher percentages, fewer maturity bands for some asset classes and without netting. Given that CEM weights – in line with the usual Basel II time horizon – estimate the potential future exposure over one year, but initial margin is meant to cover a margin period of risk of 10 days, the levels seem to be overly conservative, even taking into account that margin is calibrated to a higher percentile.
- The Trading Book Group and RMG are both looking at improved standardised methods for market and counterparty risk. Results of this work should also be used in the margin context.

Q16. 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?

- The scope of variation margin is not clear from this paper – is this in line with IM, or will variation margin be collected from all market participants, including corporates, sovereigns and central banks?

Q17. 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?

- We agree with exchanging VM on a daily basis, however for smaller counterparties (if not overly risky) less often margin calls might be acceptable. In any case calculation of the margin at t+1 as per current CSAs would cause least disruption.
- The industry has already significantly moved to risk based margining techniques over calendar based margin. Regulators and regulations need to avoid the shift of credit and market risk to operational risk where each dollar or euro of margin is moved each day – a potential with mandated low thresholds & minimum transfer amounts.

Q18. 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?

- Any pro-cyclical effects from the timely exchange of VM are far outweighed by its effectiveness as a risk mitigant, especially in times of market stress.

- Regarding the “cliff-edge” effect it is difficult to come to a solution – this will also happen in CCPs. As the scope of these margin rules will be professional counterparties, one would expect that these market participants are able to manage the riskiness of their portfolios over time. The consequence of a high margin call might even incentivise market participants to manage and mitigate sensitivity jumps in their portfolios even more closely.

Q19. What level of minimum transfer amount effectively mitigates operational risk and burden while not allowing for a significant build-up of uncollateralised exposure?

- As the minimum transfer amount (MTA) is the maximum of uncollateralized exposure than can build up, this can be set to a level that balances operational effort but captures significant daily MTM moves for the portfolio each client is likely to have against potential exposure. This level should be left for counterparties to decide, depending on size and credit quality of the counterparties. If regulators feel it to be necessary, the MTA could be capped at a few million dollars.

Eligible collateral for margin

Q20. Is the scope of proposed eligible collateral appropriate? If not, what alternative approach to eligible collateral would be preferable, and why?

- Eligible collateral requirements differ between IM and VM. Whilst for VM cash and liquid bonds floored at AA are ideal, for IM the pool of eligible collateral should be much wider, partially to mitigate the liquidity impact.
- In general, at least for prudentially-regulated banks, less liquid collateral does not pose the same problem it poses for a CCP: a bank has greater capacity to manage the risk of the collateral, greater market-access for liquidating it and enough loss absorbing capital to cover the time it might take to sell less liquid collateral.
- Also, a well diversified portfolio of collateral might overall be less risky than a concentrated portfolio with perceived high quality liquid collateral, e.g. government bonds that were thought to be riskless just a few years ago. What counts is not the credit quality and liquidity of collateral (this can be dealt with using appropriate haircuts), but the correlation between collateral and the underlying exposure.
- We welcome the wider pool of eligible collateral. As mentioned in the consultation paper, the list is not exhaustive. We suggest extending the list by
  - Banks should be permitted, but not obliged, to accept a wide range of corporate bonds and equities, i.e. not just “high quality” or “major index”, provided these positions are liquid and are maintained within concentration limits on single-issuer, country and sector exposures.
  - Commodities, not only gold. This however would require additional effort by custodians to provide a way to post these assets in a bankruptcy remote way.
  - Letters of credit, potentially floored to a minimum rating of the bank issuing these. Wrong-way risk and concentration considerations would be especially important for such collateral.
- When allowing a wider pool of collateral, strict criteria need to be defined for posted collateral. These criteria should be
  - Market depth and liquidity
  - Appropriate haircuts
  - Concentration limits (including by country, sector and industry)
  - Absence of wrong-way risk
- Counterparties should have the flexibility in bilateral agreements to agree more stringent criteria, mechanisms for haircut re-assessment, ability to react to changing credit quality of collateral (e.g. for certain government bonds whose riskiness increased considerably, with credit ratings perhaps lagging) and other ways to make sure the risk in the collateral portfolio can be managed.
- We also note that cash cannot be used for bilateral IM, as there is no reliable way to keep cash in a bankruptcy remote way. Even using a third-party custodian would just mean that the parties posting cash to their custodians add the risk of losing the collateral in case of custodian default.

Q21. 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?

- Regarding diversification requirements, we believe that even for highly liquid good quality collateral one should not be allowed to post 100% of the same or similar securities - the recent changes with some government securities show how quickly the impression of an asset to be risk-free can change. We advocate having concentration limits, which could be broken down by country, sector and industry of the underlying. It is unnecessary for regulation to provide a fixed scheme of concentration limits; agreeing these limits should be left to the counterparties, who might well wish to apply more stringent criteria than regulation could mandate.
- Diversification requirements should apply to proportions of the margin portfolio and liquidity in the open market. Whereas for cash concentration is less of a problem (this depends on the currency), for gold or corporate bonds / equities it might make sense to restrict these assets to a percentage of the overall margin, maximum amount, or proportion of daily trading volume (whatever higher) for gold, and limit concentration in a single issuer and country/sector for equities and corporate bonds.. We believe the counterparties are best placed to determine and agree the appropriate limits according to market conditions.
- If margin models are used, the use of these must be agreed between both counterparties, and less sophisticated participants should have the option of using the haircuts determined by the model of their counterparty on a consistent basis.
- Banks should be permitted to model jointly the exposure and the collateral, e.g. swap exposures covered by government bonds; equity derivative exposures covered by equities, but also between asset classes. This would allow wrong-way risks to be accounted for explicitly and recognise diversification between the exposure and the collateral.

Treatment of provided margin

Q22. 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 rules need to distinguish clearly between requirements for collateral treatment between IM and VM. A party posting IM has a claim on the assets should the receiver default, but no such claim exists for VM.
  - Bilateral IM should be kept segregated and bankruptcy remote without rehypothecation
  - Unilateral IM should have the option for segregation available
  - VM should not be restricted. VM received from one counterparty will usually be paid out to the provider(s) of the hedge(s), and not allowing VM to flow freely through the financial system would increase the liquidity drain even more, without clear benefit.
- We also note that the word “posting” needs to be clearly defined – in a tri-partite arrangement “posting” would not necessarily mean movement of collateral, but the pledging of collateral (already available at the custodian) to another counterparty.
- For IM, the key principle covers the requirements well, despite the fact that “immediately available” should include a few days delay – even if the margin is held in a tri-partite arrangement the custodian will usually take time to establish that the margin of a defaulted counterparty can be released to the counterparty of the defaulter, depending on local bankruptcy regimes.
- The onus of providing safe arrangements cannot fall on industry only: We are worried about the wording “….in the event that the collecting party enters bankruptcy to the extent possible under applicable law” – these laws need to be adapted to provide legal certainty that collateral will actually be returned. Building a margining framework that is imposed on the whole marketplace on weak foundations of potentially insufficient bankruptcy laws would be negligent.
- However, despite currently seeing only segregation at third party custodians fulfilling these conditions, we welcome that the principles describe the required outcome, not the detailed ways to achieve this outcome.

- We however note that there are material operational difficulties in the segregation of margin:
  - banks cannot post cash as IM as doing so creates even more connectivity and far higher capital charges (as an unsecured loan is deemed to be being made to the agent bank);
  - The pledging of securities (certainly not cash) seems the only way that this process could work, but it is key that these connections are fully automated (which is not the case at present) to permit timely release of collateral;
  - Operational challenges: the tri-partite clearing market at present is not geared up to high volumes and straight-through-processing
  - Significant systems spend will be required up-front to monitor and manage collateral held at third parties and the cost of managing this collateral on an on-going basis will rise.
  - Increased concentration of collateral at a small number of tri-partite providers: an operational failure or fraud at one of these institutions would have broad systematic implications.
  - Universal two way margining will increase the level of operational risk with significant amount of cash and non-cash margin transferring ownership and/or pledge accounting each business day.
  - Disputes will likely increase and will put pressure on infrastructure potentially taking longer to resolve.
- Rules need to be introduced for the default of a custodian. In this situation, the counterparty of the entity that posted collateral to a defaulted custodian should not have to treat this collateral as lost, but rely on mechanisms to either recover or port this collateral in a timely fashion in the framework of the resolution plan of the custodian. Requiring the counterparty to post IM a second time would exacerbate liquidity requirements exactly in stressed market conditions.

Q23. 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?

- Despite the fact that segregated gross posting of collateral will require large amounts of collateral, we agree that netting of IM would not be effective and could even increase risk.
- There are only a few global custodians that would have the ability to provide tri-partite custody service to the industry on a global basis. For some countries, most of them will share sub-custodians. Therefore we are worried about the concentration risk with third-party custodian banks, especially as some of them are also derivatives market participants.
- However this custodian risk could be mitigated by stringent Recovery and Resolution Plans. Also mechanisms similar to portability from defaulting clearing members could be introduced to make sure that collateral is not tied up in custodian defaults for a long time.
- Whilst overall the use of tri-partite arrangements seems to be the best alternative, there is still some legal risk, e.g. custody liens and the risk attached to sub-custodians in the prime-brokerage context.

Q24. 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?

- We assume the consultation paper talks about IM only when mandating that collateral should not be re-hypothecated. VM clearly should not be restricted in this way, and market participants should be free to pay received VM to other counterparties where they have to post VM, e.g. the providers of the hedges.
- As for the model suggested by US SEC, it would be desirable that there was a method to safely re-use IM, as this would mitigate the liquidity impact. However we cannot see any credible way achieving this. As we have

seen with recent events (MF Global and Peregrine), segregation of client money in a firm's books does not provide the required protection

- However in cases where only one counterparty posts IM (i.e. a systemic important institution dealing with a non-systemic important institution), segregation and re-use should not be mandated, but left to negotiation of both counterparties. The client should have the choice to make the trade-off between cost and protection level.

Treatment of transactions with affiliates

Q25. 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?

- We already post VM between HSBC affiliates where possible and legally enforceable. However we are opposed to national regulators being able to impose IM. This would introduce inconsistencies and might incentivise the booking of businesses in other entities which might be less well equipped to deal with the risk.
- It is unclear whether the IM would be unilateral or bilateral should a national regulator impose the exchange of IM on affiliates of a group.
- A bank with a subsidiary structure is safer and inherently easier to resolve than if the whole business were to be kept on one balance sheet. However so far this model hasn't been incentivised by regulation, more often even penalised. Mandating exchange of IM between affiliates would further push firms to a single balance sheet model.
- Obliging daily VM exchange between affiliates will require each side to hold more liquid assets than they may otherwise require, contrary to the assertion in the second paragraph on p. 27.

Q26. 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?

- In case of two separate legal entities, it should make no difference in terms of VM whether these are in the same or different jurisdictions.
- We note, however, that some subsidiaries of HSBC are in locations where netting and collateral are not enforceable. Margining of transactions in such jurisdictions can increase risk and therefore should not be mandated. However regulation should be flexible enough for affiliates in such jurisdictions still being able to manage the risk within their group. I.e. the fact that margining is not possible due to legal differences should not mean that affiliates cannot transact with each other.

Interaction of national regimes in cross-border transactions

Q27. 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?

- For bilateral margining, IM requirements should be calculated in the same way for both counterparties of a transaction (even if different thresholds are negotiated). We therefore question how exactly the exchange of IM should work if one of the two counterparties is subject to different rules, e.g. different model requirements, or additional buffers for macroprudential ends as proposed in element 3 on page 20 of the consultation paper. Would the stricter margin requirements cover the posted or received IM of the firm in that jurisdiction, or both firms? How should firms know which rules to follow when trading with counterparties in other jurisdictions? In the worst case a firm would have to run margin models for each jurisdiction of its counterparties.
- The cross-border examples in the paper are examples of where a participant will be forced to use its counterparty's model: if a German bank is collecting IM under German rules and its US bank counterparty is

using US rules then each will necessarily rely on the other's margin model. It would be desirable for the same rules to apply globally.

- So far no consultation paper covering margining of un-cleared transactions has suggested solutions how to deal with counterparties in jurisdictions where netting and/or collateral documentation is not enforceable. In such jurisdictions both IM and VM would not necessary mitigate risk, more likely even increase risk. Would we be prohibited from trading with counterparties in such jurisdictions?