Ref; CHC/54/H24

September 28, 2012

Comments on the Consultative Document from Basel Committee on Banking Supervision
and the International Organization of Securities Commissions':
Margin requirements for non-centrally-cleared derivatives

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document: Margin requirements for non-centrally-cleared derivatives, released on July 6, 2012 by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

We hope that our comments below will be of assistance and perhaps offer an additional point of reference as you work towards finalizing the rules proposed by BCBS and IOSCO.

<Introduction>

We respectfully present our concerns over the proposed requirements in the consultative document *Margin requirements for non-centrally-cleared derivatives*.

Since the financial crisis, over-the-counter ("OTC") market reforms have been promoted by supervisors and derivative market participants. It is understood that the foundation of such reforms is the following commitments made at G20 Pittsburgh Summit held in September 2009: (i) All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest; (ii) OTC derivative contracts should be reported to trade repositories; and (iii) Non-centrally cleared contracts should be subject to higher capital requirements. We are further aware that G20 Cannes Summit held in November 2011 requested the BCBS and IOSCO to develop consistent global standards with regards to *Margin requirements for non-centrally-cleared derivatives*, and of challenges that system risk mitigation initiatives shall be steadily pushed forward.

However, as noted in third progress report on the implementation of OTC derivatives market reforms published by Financial Stability Board (FSB) in June 2012, the progress of reforms committed to be achieved at G20 Pittsburgh Summit, including the central clearing regime which is inextricably associated with the proposed margin requirements, showed gaps in implementation across jurisdictions, and whether international reforms can be completed by the implementation deadline,

end-2012, has become uncertain. Given such a situation, our basic position is that priority should be placed on steady implementation of initiatives that were committed at the G20 Pittsburgh Summit and have already moved into action. Further, in introducing the proposed requirements, it is considered crucial to carry out sufficient analysis and assess impacts, and ensure that a sufficient preparation period be set for implementation in light of such analysis and assessment.

The proposed margin requirements are not fully aligned with other international requirements or requirements developed in each jurisdiction, including the central clearing regime as well as the capital and liquidity requirements under Basel III (such as capital charges on credit valuation adjustments (CVA)), giving rise to overlapping and inconsistencies in some areas. For example, the liquidity coverage ratio (LCR) under the liquidity requirements requires banks to hold high-quality liquid assets such as government bonds; whereas the proposed margin requirements require banks to provide highly liquid assets to their counterparties as margin. Hence, some jurisdictions may be adversely affected by the margin requirements. If consistency is not ensured in discussing the proposed margin requirements, unintended risk may be crystallized, or regulatory arbitrage and competitive advantage may emerge across jurisdictions. In light of this, in introducing the proposed margin requirements, it is considered essential to factor in both overall regulations of financial and OTC derivative transactions and market practices of OTC derivatives (including ISDA – CSA (Credit Support Annex)), and to develop requirements that align with international rules as well as regulations in each jurisdiction already in place.

Moreover, as commented below, the issues addressed in this consultative paper are extensive, and hence impacts of these on legislative frameworks, business practices and accounting standards cannot be viewed as de minimis. Therefore, it is requested that impacts on these be taken fully into account and assessed in discussing the proposed margin requirements.

<General Comments>

1. Concerns over consistency with prudential regulations

The consultative document highlights reduction of systemic risk as an objective of introducing these requirements. Systemically important financial institutions (SIFIs), particularly global systemically important financial institutions (G-SIFIs), that are considered to have systemic risk are subject to capital surcharges, and the development of recovery and resolution plans is underway. It is understood that the SIFI designation process quantitatively assesses interconnectedness and size of derivative transactions in order to measure the systemic importance factoring in derivative

transactions for enhancing regulations over SIFIs. Given that the enhancements to regulations over SIFIs have been introduced as stated above, we respectfully request a careful consideration so as not to impose excessive margin requirements.

Further, all of risk assets held by Japanese banks, including derivative positions, are subject to the capital requirements under the Basel regime. These risk assets include unsecured derivative positions, and Basel III requirements currently being introduced are expected to strictly capture changes in present value (fair value) of such derivative transactions through the introduction of capital requirements for credit valuation adjustments (CVA). For banks subject to the capital requirements, regardless of a difference in the nature of the both requirements in that the margin requirements are on the basis of the “defaulters pay” concept; whereas the additional capital requirements are on the basis of the “survivors pay” concept, the proposed margin requirements apparently place a double burden on such banks. We therefore request the BCBS and IOSCO to develop a regime that fully consider a level playing field with other sectors not subject to the capital requirements.

Moreover, Basel II.5 and Basel III require banks prudential capital requirements for (complicated) non-centrally cleared financial instruments. It is assumed that setting standardised central clearing requirements for such instruments is difficult, and also transferring to the central clearing system is impracticable if the transaction volume of such market is small. In light of this, we respectfully request the BCBS and IOSCO’s consideration to ensure a balance between banks under the capital requirements and the other sectors not subject to such requirements, for financial instruments which are considered to be unrealistic to fully transfer to the central clearing system.

2. Concerns from macro-economic perspectives

From the macro-economic standpoint, OTC derivative transactions are closely linked to needs of hedging FX risk, interest rate risk and other risks arising from the real economy including general companies engaged in the primary industry (agricultural, forestry and fisheries) and the secondary industry (mining and industrial) as well as from investment by various pensions. It is requested that indispensable needs of banks be recognized – more specifically, banks need to make adjustments to market and credit risks associated with interest rate, foreign exchange and credit which are inherent to investment and lending activities of banks. There is a concern that the introduction of the proposed margin requirements may increase transaction costs of OTC derivatives, and as a consequence, a negative impact such as pass-on of costs to customers with risk hedge needs may arise. Moreover, if a bank finds it difficult to make necessary adjustments to risks, a concern over the amplification of systemic risk may also arise.

In light of the above, the proposed requirements may have an impact on non-financial entities, or general companies. Therefore, we respectfully request the BCBS and IOSCO to clarify its view on the definition of systematically-important non-financial entities referred to in the consultative document in the context of general companies. The scope of the systematically-important non-financial entities may, for example, include non-financial entities which are required to participate in central clearing on the basis of volume or exposure of OTC derivatives. Further, it is understood that transactions between financial firms and general companies which are not deemed to be "systematically important non-financial entities" are excluded from the scope of the proposed requirements, and is hence requested that this is clarified in the requirements. We are of the opinion that at least in Japan, the necessity of applying the proposed requirements to general companies is low because, contrary to large transactions executed between financial firms, transactions with general companies are small-lot and deconcentrated, with a considerably low probability of systemic risk occurrence.

3. Concern over implementing the requirements of exchanging initial margin

The consultative document proposes the implementation of initial margin exchange requirements as a tool for protecting derivative market participants from potential future exposure. However, as stated in the consultative document, exchange on a gross basis, if it becomes mandatory, may give rise to the following issues: it may have a significant impact on the financial market through an increase in liquidity demand and transaction costs; the financial firms may be under pressure by bigger balance sheet and risk weighted assets in case of not applying the netting of initial margin; and additional operational risk may emerge due to the concentration of collateral management to certain custodians at a global level. To address such issues, the consultative document states that concerns over an increase in liquidity demand and transaction costs will be contemplated along with the quantitative impact study (QIS). Our perception is that the impact of margin requirements on the financial market is immense.

Given the issues identified above, we respectfully request that, in considering the introduction of this requirement, the universal two-way margin regime should be applied only to variation margin as a risk mitigation functioning as a complementary tool for the capital requirements, not mandatorily requiring exchange of initial margins.

4. Use of ISDA - CSA

Even if the margin requirements are applied only to variation margin, it is expected that developing a framework and infrastructure in each jurisdiction with a global mindset and ensuring consistency will impose a considerable burden and cost on both supervisors and market participants in each jurisdiction. At the same time, as is well known, ISDA – Credit Support Annex (CSA) is an established global market practice for OTC derivatives, which intends to reduce counterparty risk through the exchange of collateral which has an equivalent function as variation margin at a certain frequency. It is considered that the proposed requirements, apart from some requirements such as initial margin requirement, in this consultative document are broadly consistent with the underlying concepts of ISDA-CSA. In addition, ISDA is undertaking an effort to standardise CSA (Standard Credit Support Annex: SCSA). Accordingly, to facilitate the efficient and reasonable introduction of margin requirements at a global level, the starting point of the discussion shall be primarily on the use of ISDA-CSA, with a focus on exchange of variable margin on a net basis for MTM. Further, we seek that discussions shall be processed in a way consistent with the SCSA’s initiative.

It should, however, be recognized that, unlike Europe and U.S., the degree of use of ISDA-CSA is low in the Asian regions including Japan, and hence market practices of exchanging margin differ across jurisdictions at present. In addition, in Japan, a unique business practice exists where a bank transaction agreement that covers all bank transactions is singed and collateral is established on customers’ assets including fixed assets such as real estate, thereby allowing exposures to be protected in a comprehensive manner, not on an individual contract basis. As such, risks associated with OTC derivatives executed with general companies are reduced to some extent, without exchanging margin. Therefore, the necessity of requiring financial firms to receive eligible collateral only for OTC transactions as is the case in Europe and U.S. is considered to be not high. Under such market practices, if the application of proposed margin requirements extends to general companies as “systematically-important non-financial entities”, there are concerns that it may be difficult to obtain buy-in from these general companies when requesting margin and collateral; such margin and collateral may have an adverse impact on cash positions of customers; the expansion of operational infrastructure may be necessitated; and the number of legal experts are limited.

Accordingly, as mentioned in “Introduction”, we respectfully request to construct a regulatory framework that factors in the degree of CSA being used in each jurisdiction and characteristics of each jurisdiction such as business practices.

5. Requirements on cross-border transactions

From the standpoint of avoiding regulatory arbitrage and competitive advantages across jurisdictions, in essence, it is considered necessary to design globally consistent tools and institutional design for the contents and timing of introduction for the proposed requirements. On the other hand, as stated in “Introduction”, given the fact that an implementation gap arises across jurisdictions for the initiatives of OTC derivative market regulatory reforms which are inextricably linked to the proposed requirements, we are concerned that the introduction of the proposed requirements may give rise to differences across jurisdictions in terms of contents and timing of introduction. Particularly for cross border transactions, a case where one party may be subject to the proposed requirements in its host country, while the other party may not be subject to the proposed requirements in its host country may be assumed, which is highly likely to cause unfair cases such as only one party is being required to post margin, giving rise to various conflicts.

Therefore, the best way to avoid conflicts is to limit the application of the proposed requirements to cross-border transactions in cases where the host countries of both parties have introduced the proposed requirements. Further, it is considered necessary to clarify that the jurisdiction of a party shall be determined on a legal-entity basis, and that an overseas branch of a financial institution should be subject to the requirements of the home country of the head office, while a locally incorporated company should be subject to the requirements of its host country.

<Specific Comments>

[Part 1] Implementation and timing of margin requirements

Q1. Timing for the implementation of margin requirements on non-centrally-cleared derivatives

As described in “General Comments”, in implementing the margin requirements, it is essential to ensure consistency in terms of both contents and timing with other financial regulatory initiatives such as central clearing regime and capital requirements. In particular, given that the margin requirements are inextricably linked to the central clearing regime, a discussion on the margin requirements should be made in harmony with the scope and progress of the central clearing regime at each jurisdiction. The margin requirements should not be discussed independently. We believe that the contents and timing of the implementation of margin requirements should be discussed only after a series of development of central clearing regime are completed at each jurisdiction and the scope of non-centrally-cleared derivatives is clarified for practical purposes.

It is considered that, in essence, the contents and timing of margin requirements need to be founded

on globally consistent tools and institutional design. However, as commented above, since gaps exist across jurisdictions under the current central clearing regime, a priority should be first placed on facilitating international efforts and collaboration on central clearing in order to achieve the unification of definition and contents of "non-centrally-cleared derivatives". For the benefits of banks' customers, it is desirable to offer options to select either to use central clearing via the client clearing by assuming costs or alternatively to settle without using centrally clearing, allowing banks' customers leeway for judgment based on costs and benefits.

Element 1: Scope of coverage – instruments subject to the requirements
Q2. Treatment of foreign exchange swaps and forwards

Foreign exchange swaps and forwards should all be exempted from the margin requirements regardless of the tenor of transactions.

These transactions are widely used for foreign currency funding or hedging of assets denominated in a foreign currency, and serve an essential function in the traditional commercial banking. Furthermore, since, under the regulations of most of jurisdictions, these transactions are exempted from the central clearing mandate, and these transactions are not subject to the central clearing service of major CCPs, it is considered that the application of margin requirements to these transactions does not lead to the promotion of central clearing. Moreover, from a standpoint of systemic risk, since the maturity of most transactions are less than one year, and considering that adequate liquidity was maintained in this market in the extreme stress period of Lehman Shock, it is assumed that positions can be immediately replaced even in the event of a counterparty's default. In addition, considering the current practice where not all foreign exchange related transactions are subject to the ISDA Master Agreement even in interbank transactions, if margin requirements are applied to these transactions, operational workload such as maintenance of documentation is considered to be significant compared to other transactions.

Based on the above-mentioned current practices, given the significant impact on these transactions as compared to other types of derivatives, we consider that there lack reasonable grounds for applying the margin requirements to these transactions, regardless of tenor of transactions such as one year.

Q3. Additional specific product exemptions that should be considered

In addition to foreign exchange swaps and forwards that are discussed in this consultative document,

there are other products that should be considered to be exempted from the margin requirements based on their characteristics of products and schemes.

From a product viewpoint, it is requested that a consideration be made to exempt non-deliverable forwards (NDFs) from the application of the proposed margin requirements. In particular, we request a consideration on NDFs taking into account that, as is the case with foreign exchange forwards, NDFs are used for hedging of assets denominated in a foreign currency, that gaps exist in the treatment of central clearing in certain jurisdictions, and that NDFs are used as an alternative for foreign exchange forwards in Asian markets where foreign exchange forwards are prohibited under local currency regulations.

Moreover, it is requested that plain-vanilla currency swaps, especially those types of currency swaps whose principals are marked-to-market every interest payment date, is considered for the exemption from the proposed margin requirements, considering that these transactions are not only used for investment or loan by financial firms, but also used by sovereign or general companies for the purposes of funding in foreign currency and trade, and that there is a risk that a steep increase in transaction costs may have an adverse impact on the real economy such as through stagnation of international activities and trade contraction.

From a viewpoint of a scheme, we respectfully request that trust accounts be exempted from the scope of margin requirements. Under the trust account scheme, even if trust banks act as a party to the transaction, since trust banks have a segregated management obligation, trust accounts are kept remote from credit risk of a trust bank (i.e. funds will not default even if a trust bank goes bankrupt). Failure of a counterparty, if occurred, may not have an impact on a custodian bank responsible for custody of the trust accounts. In addition, even though there are cases where trust accounts in Japan enter into OTC derivatives in order to redeem and pay dividends in line with expected cash flows, a risk limit is set for such OTC derivatives transactions depending on the size of fund assets. As for products such as investment trusts and pension trusts, assets under management are segregated from trustees' proprietary accounts and thus, so long as related costs of derivative transactions are paid out from fund assets, the fund's default risk is considered to be sufficiently covered from the viewpoint of fund's counterparty.

If, nevertheless, trust accounts would be subject to the proposed margin requirements, there is a concern that problems, such as a difficulty in making payments of distributions to beneficiaries due to cash of trust accounts used for exchanging margins, may occur and invite a downgrading of credit rating of funds or a difficulty in principal and dividend payments, causing a significant adverse

impact on the operation of a trust scheme.

[Element 2]

Q4. Key principle for scope of applicability

In this consultative document, financial firms are primarily assumed to be included in the scope of applicability. However, Japanese banks are required to maintain a certain level of own resource for derivative transactions that are covered by the proposed margin requirements through the implementation of the capital requirements under the Basel regime, especially Basel III, not only for derivative transactions, but for all risk assets. Given such regulatory developments, if the basic framework of the margin requirements is to be retained, it is requested that, from the standpoint of ensuring a level playing field, a sufficient consideration be paid in defining a threshold and other matters, taking into account that the capital requirements are already being imposed.

Additionally, even for financial firms, it is reasonable to deem that market participants and transactions to which the central clearing mandate is applied in a phased manner under each jurisdiction's central clearing regime have a lower possibility of causing systemic risk. Therefore, exemption of such market participants and transactions from the margin requirements should also be considered.

Further, as described in "General Comments: Item 2", we respectfully emphasise our request for clarifying the definition of "systemically-important non-financial entities" as well as our concern over the potential impact on general companies in consideration of business practices in Japan.

Moreover, in relation to the exemption of sovereigns and central banks from the margin requirements as set out in the consultative document, clarification as to whether international organizations are subject to margin requirements or not would be appreciated.

Q5-Q8. Setting of initial margin thresholds

As discussed in "General Comments: Item 3", our request is not to mandatorily apply the margin requirements to initial margins. We would further like to provide the following comments as we think these will support our discussion.

As noted in "General Comments: Item 4", our request is that the margin requirements should

primarily impose only the exchange of variation margin, and this requirement should be considered under the assumption that ISDA-CSA is used. Further, when implementing the requirement for variation margin exchange, it is considered that setting a threshold complies with the current market practices. However, even in discussing the establishment of a global framework for each regulated entity as set out in the consultative document, given that, under current market practices, a threshold is determined as a result of negotiation between parties to a transaction, a realistic approach is to ensure a certain flexibility so that the relationship between parties to a transaction can be considered.

In addition, as stated in Q4, if the initial margin regime is to be retained, prudentially-regulated entities, regardless of whether they fall into the category of "key market participants", should be allowed to set sufficient thresholds, taking into account that these entities are subject to capital requirements that serve as a risk mitigant. In such cases, the setting of the threshold level should be left to national supervisors' discretion based on the each jurisdiction's market size.

Q9. Impact of requiring universal two-way margin on capital and liquidity of market participants

Exchange of initial margin, if it becomes mandatory, may have a significant impact on financial markets due to an increase in liquidity demand and transaction costs. It is understood that measurement of the magnitude of such overall impact will be discussed based on the results of QIS; however, if universal two-way margin becomes mandatory, there may be a sharp increase in demand for eligible collateral from counterparties, causing a concern that this might invite liquidity shortage and trigger market malfunctioning. Therefore, as stated in "General Comments: Item 3", we believe that our proposal to discuss the margin requirements from a standpoint of net-base exchange of variation margin based on mark-to-market (MTM), is reasonable.

[Element 3]

Q13-Q16. Baseline minimum amounts and methodologies for initial and variation margin

As discussed in "General Comments: Item 3", our request is not to mandatorily apply the margin requirements to initial margins. We would further like to provide the following comments as we think these will support our discussion.

As for an exchange of initial margin, while this consultative document provides Proposed Standardised Initial Margin Schedule (Appendix A), several methodologies such as the use of internal models that are approved by national supervisors are allowed based on the judgment of each

financial firm. However, since the logic of internal models may differ among financial firms and an evaluation rate, volatility and timing of the evaluation for risk management purposes are assumed to be not identical among financial firms, there is a significant concern that workload may be entailed for reconciliation between counterparties, and that a negotiation or dispute may frequently occur among counterparties. It is understood that the consultative document expects best efforts on the part of counterparties, but market participants' burden for such efforts is anticipated to be significant.

To avoid such disputes, an effective approach may be to use simple calculation methods such as proposed standardised schedule so as to prevent inconsistencies between parties. However, considering that the amount of required margin may be conservatively calculated as compared to the amount calculated using internal models, it might not be a reasonable option for market participants.

If a potential exposure calculation model under the Basel requirements is allowed to be used for initial margin calculation, there is a benefit that the approval of margin calculation models of respective financial firms can be omitted. However, even in such a case, the problem of gaps in calculation models among financial firms still remains.

In light of the above, we believe that it is difficult to find a realistic approach for initial margin calculation, even considering the practice of initial margin calculation in the future.

The consultative document states that the calculation of initial margin should be based on VaR using a 10-day horizon. We respectfully seek clarification on the grounds for setting a 10-day horizon. For those markets that maintained sufficient liquidity even during a period of financial stress, positions can be replaced in a few days even when estimating conservatively. Thus, limiting to a 10-day horizon is considered to lack reasonable grounds.

Q17. Frequency of variation margin payments

While the consultative document proposes that, in principle, variation margin be exchanged on a daily basis, we believe that other options should be given, for example, allowing the weekly exchange of variation margin, taking into consideration the differences in current market practices or the infrastructure for margin payments across jurisdictions. The weekly variation margin payment is considered as appropriate and sufficient frequency in light of the current control self assessment (CSA) cycle which reflects the degree of difficulty of assessment and liquidity of collateral assets.

Q19. Operational burden

To keep exposures to a certain level and at the same time to reduce the operational burden for collateral transfers, it is considered vital to permit the setting of a minimum transfer amount (MTA). For credit risk management purposes, the effectiveness of MTA increases when such an amount is set at zero or when it is minimized as much as possible. However, to reduce operational burden, current market practices allow, for example, setting an MTA at a level of a few million dollars, depending on counterparty credit quality. In this view, even if the cap of an MTA is defined by the supervisors, latitude should be given to allow each entity to set MTA, taking into account the counterparty credit quality and other factors in reference to current market practices, in order to avoid a sharp increase in operational burden.

[Element 4]

Q20. Scope of eligible collateral for margin

We are concerned that allowing jurisdictions to develop their own list of eligible collateral assets will give rise to differences among jurisdictions. For example, if each jurisdiction limits the scope of eligible collateral to assets traded in its home market, a party to a cross-border transaction needs to obtain and post collateral deemed eligible at the counterparty's home country, which may cause a disadvantage to parties in terms of cost and ease of obtaining collateral.

In terms of assets with sufficient liquidity and size of the market such as Japanese government bonds, it is considered appropriate to extensively allow such assets to be eligible collateral, regardless of jurisdictions, and such treatment is assumed.

Q21. Concentration limits on eligible collateral and the standardised haircuts

Diversification requirements, such as concentration limits, need to be flexibly determined according to the size and liquidity of a market. If those government bonds with a sufficient liquidity (eg Japanese government bonds) are subject to the same concentration limits as other government bonds or international agency bonds and general corporate bonds (with relatively low liquidity), such government bonds will face unfavorable conditions in terms of market size or issuance volume, which may lead to downgrading of the relative value of the bonds.

The standardised haircut schedule set out in Appendix B proposes that a haircut for "Cash in

different currency" be 8%; however, a more specific definition regarding the "different currency" would be appreciated. If the intention of the proposed requirement is to regard the U.S. dollar as a key currency with other currencies deemed as "different currency", this will give an advantage to U.S. financial institutions and put non-U.S. financial institutions at a considerable disadvantage. Taking this into consideration, the standardised haircuts should ensure level playing fields, regardless of the host country in which an entity is located.

[Element 5]

Q23. Exchange of initial margin on a gross basis

As discussed in "General Comments: Item 3", it is requested that the proposed requirements not be applied to initial margin including its exchange on a gross basis. As mentioned in the consultative document, there is a strong concern that the requirement may result in large amounts of initial margin held by a potentially small number of custodian banks thus creating concentration risk.

As there are only a limited number of financial institutions engaged in the custodian business at present, if the proposed requirement is implemented in a short time frame, it is highly likely that a new operational risk may emerge through the concentration of collateral management activity to certain custodians at a global level. Further, it is considered necessary to note that, unlike highly public CCPs, the business of custodians is not necessarily highly transparent for customers.

It should also be noted that imposing the segregated management requirement of initial margin to custodians may trigger disputes over cost sharing among related parties and may also reduce liquidity.

Q24. Re-hypothecation or re-use

It is often the case that treatment of collateral differs across jurisdictions as such treatment is dependent on their basic legislation, such as a bankruptcy law and civil code. Also, such differences will not be removed in a short term. It is expected that the BCBS and IOSCO take into account these points in discussing the proposed principles and requirements. As is obvious, G20 also calls on coordination and collaboration across jurisdictions for cross-border transactions. Given this, the proposed requirements on collateral treatment should reflect the results of robust preliminary research and review of basic legislation in each jurisdiction.

It is understood that prohibiting re-hypothecation or re-use has an advantage in that margin would be readily available to the collecting party upon default of the counterparty. However, such prohibition causes inconsistency with other transactions given that there is no specific regulation which prohibits re-hypothecation or re-use for non-derivative transactions. Further, limiting funding sources may increase funding cost. These disadvantageous aspects are considered to overwhelm the benefit of the immediate availability.

[Element 6]

Q25-26. Treatment of transactions with affiliates

We strongly recommend that both initial and variation margin on transactions between a firm and its affiliates, regardless of whether within the same jurisdiction, should be scoped out of the proposed margin requirements.

Even if the margin requirements are extended to transactions between affiliates for purposes of achieving the systemic risk reduction, the legal protection effect and economic effect of risk reduction of mandating such requirements are deemed to be extremely low; because the bankruptcy of a parent evidently has a chain effect on all inter-affiliate transactions (as these transactions are often guaranteed by the parent). In this view, it is considered unnecessary to require an exchange of both initial and variation margin for inter-affiliate transactions.

The consultative document proposes that discretion be given to national supervisors in determining whether to apply initial margin requirements to transactions between a firm and its affiliates. Such discretion, if given, is expected to result in regulatory inconsistencies in the case of cross-border transactions. Further, given that between affiliates, cash and government bonds are generally invested and managed efficiently and an exchange of margin is not a common practice, requiring variation margin on inter-affiliate transactions may merely create additional liquidity demands.

[Element 7]

Q27. Interaction of national regimes in cross-border transactions

As our concerns and requests expressed in “General Comments: Item 5”, considering the degree of impact the proposed requirements have, it is difficult for financial firms to independently assess whether the margin requirements at home and host countries is consistent when they engage in a

cross-border transaction. If the margin requirements are implemented without sufficient interaction at a national jurisdiction level, an excessive burden will be imposed on risk management framework, systems and other relevant areas. Therefore, national supervisors are requested to ensure sufficiently consistent and non-duplicative regulatory margin requirements across jurisdictions.

As noted in our comment to Q24, such interaction of national supervisors is required not only for the issues associated with the initial and variation margin requirements and the scope of applicability, but also for other issues including the basic legislation such as a bankruptcy law and civil code in each jurisdiction and obligation of segregated account management. Therefore, we fully support the comment given in page 30 of the consultative document - "Supervisors should seek to promote and facilitate close cooperation and coordination among supervisors for cross-border implementation of margin requirements."

The consultative document also mentions in page 30 that "Where the rules in the home and host jurisdictions are different, the subsidiary/branch shall observe the more stringent of the two, thereby satisfying both the home-country and the host-country requirements..." Ensuring a level playing field is a key in developing global regulations. We understand that there may be instances where minimum standards are established on a global basis, while more stringent requirements are set at the discretion of respective jurisdictions. However, requiring financial institutions to apply the more stringent of the two as an international rule would place one party to be directly impacted by regulations set by non-home supervisors, which may trigger conflicts. We therefore are of the opinion that such requirement be avoided.