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Via Electronic Submission: **baselcommittee@bis.org**
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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

Re: Consultative Document Regarding Margin Requirements for Non-Centrally-Cleared Derivatives (the "Consultative Document")

Dear Sir or Madam:

We appreciate this opportunity to comment on the Consultative Document prepared by the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO") joint Working Group on Margining Requirements ("WGMR") relating to minimum standards for margin for non-centrally-cleared derivatives (referred to herein as "uncleared derivatives").[1] We provide our comments from the perspective of the buy-side of the market. Along with both buy- and sell-side institutions, we support the BCBS' and IOSCO's efforts to reduce risk and promote stability in the global financial markets, while also maintaining a robust market for centrally-cleared derivatives (referred to herein as "cleared derivatives") and uncleared derivatives to suit the varying needs of a wide range of market participants.

As described in more detail below, we respectfully request that the BCBS and IOSCO: (i) require bilateral exchange of initial and variation margin and permit parties to negotiate appropriate

[1] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, Consultative Document, Margin Requirements for Non-Centrally-Cleared Derivatives (July 2012).

thresholds for initial margin; and (ii) expressly permit netting of initial margin for uncleared derivatives.

I. <u>Bilateral Exchange of Initial Margin, Subject to Thresholds, and Variation Margin</u>

Element 2 of the Consultative Document discusses proposals with respect to exchange of margin. In this regard, the Consultative Document contemplates that there will be two categories of possible transactions – one as to which margin requirements do not need to be applied, and one as to which there will be margin requirements. The Consultative Document notes that "there was broad consensus within the BCBS and IOSCO that the margin requirements need not apply to non-centrally-cleared derivatives to which non-financial entities that are not systemically important are a party." We agree with and support this consensus not to impose regulatory margin requirements on this category of derivatives.

As to derivatives that should be subject to margin requirements, the Consultative Document notes that a majority of the BCBS and IOSCO members supported mandatory exchange of both initial and variation margin between parties to uncleared derivatives, other than as noted above. We support the proposed requirement that parties to uncleared derivatives exchange initial and variation margin on a bilateral basis. Bilateral exchange of margin will have the effect of reducing systemic risk in the financial markets and limiting the amount of unsecured exposure between derivative counterparties. Bilateral exchange of variation margin addresses actual current mark-to-market exposures (*i.e.*, losses) between counterparties and its daily exchange helps to avoid accumulation of large, uncollateralized losses that a party may not be able to cover during a time of significant market stress. It is standard market practice for parties to derivative transactions to exchange bilateral variation margin. Requiring the bilateral exchange of variation margin would reinforce this sound market practice, causing little disruption to the market.

We also support the bilateral exchange of initial margin, subject to thresholds, as discussed in the Consultative Document. We agree with the BCBS and IOSCO that thresholds are appropriate in the context of initial margin, whereas full exchange of variation margin is generally required to protect against the accumulation of large uncollateralized losses. However, we do not believe that it is appropriate in this context to establish a uniform approach to initial margin thresholds, or to distinguish between entities based on whether or not they are a financial entity or are prudentially regulated or systemically important (or any other similar criteria). Instead of following a one-size-fits-all approach within the various categories of market participants, we urge the BCBS and IOSCO to give parties to uncleared derivatives more discretion to determine whether, and to what extent, a threshold will apply to initial margin. As the BCBS and IOSCO are aware, even within the "financial entity" and "systemically important non-financial entity" categories, there exists a wide variety of size, sophistication, experience, creditworthiness and financial resources. To assume that all entities within these categories pose the same amount of risk – and therefore should be required to post the same amount of initial margin – ignores this variety, leaving those sophisticated and

creditworthy financial entities that have robust risk management practices with disproportionate amounts of capital tied up with their dealer counterparties. It is difficult to understand how this scenario serves to reduce risk or promote stability in the financial system.[2]

We respectfully submit that parties to uncleared derivatives that are subject to margin requirements should be permitted to use thresholds that are determined by contract and customized by the parties to the derivative trade, and otherwise subject to a maximum threshold amount that would apply across the universe of entities to which the margin requirements will apply (financial entities, systemically important non-financial entities, or otherwise). We believe that the parties to the derivative trade – especially where the parties have had a longstanding trading relationship – are in the best position to evaluate each other's creditworthiness and to determine an appropriate threshold amount for initial margin.

II. Netting of Initial Margin

The Consultative Document proposes that parties to an uncleared derivative that are required to exchange initial margin be required to do so on a gross, rather than net, basis. Large institutional investors are concerned that such a requirement would adversely affect an investor's liquidity profile by requiring the investor to provide potentially significant amounts of initial margin to its counterparties. Permitting parties to net initial margin will allow parties to provide an amount of margin that appropriately reflects overall potential future exposure to a counterparty, taking into account any collateral received from the counterparty. Furthermore, we agree with and support the statements in the Consultative Document that initial margin should be immediately available to the collecting party in the event of a counterparty's default and that initial margin should be subject to arrangements that fully protect the counterparty to the extent possible under applicable law in the event of the collecting party's bankruptcy.

We appreciate the BCBS' and IOSCO's attention to these comments.

Sincerely yours,

/s/ Christopher A. Klem /s/ Leigh R. Fraser /s/ Molly Moore

Christopher A. Klem Leigh R. Fraser Molly Moore

[2] It can, of course, be argued that all large derivatives traders pose more systemic risk and are more likely to impact the market during times of financial stress than other types of investors. However, even within the category of large derivatives traders, there exist many entities that have strong risk management and compliance resources, and long-term experience and sophistication in derivatives trading, and, though large, in practice pose little threat to the overall financial system due to their resources, abilities to absorb losses, objectives and methods.