28 September 2012

International Organisation of Securities Commissions

C/Oquendo 12

28006 Madrid

Spain

Dear Sirs,

Re: Consultative document: Margin requirements for non-centrally cleared derivatives

Thank you for the opportunity to respond to this consultative document. We support the policy objective of making OTC derivatives markets safer and more transparent by requiring that, where appropriate, they are traded on regulated markets, cleared via central counterparties, and reported to trade repositories. Market participants, including Standard Chartered Bank, have been working with the regulators and the industry bodies across the globe to make this happen.

We also understand the aims behind the G20 decision to add margin requirements for non-centrally cleared derivatives to the reform programme. This is intended to create systemic resiliency by incentivising central clearing and offering enhanced protection against counterparty risk.

However, the consultation document states that the potential benefits of margining must be weighed against the liquidity impacts that it would create. If implemented as proposed, we are not convinced this balance would be achieved. For the reasons which follow, we believe the rules would have a disproportionate and inequitable impact on banks like Standard Chartered with businesses focused in emerging markets:

- Market infrastructure outside of the established western market hubs is still evolving. Even for a large international bank like Standard Chartered, today less than 10% of our OTC derivatives trades are clearable on any CCP globally. UK and US CCPs offer a limited and western-focused product suite, while CCPs outside these markets, such as those in Asia, are still building their basic infrastructure. It is therefore expected that a large proportion of the OTC derivatives transacted by emerging markets-focused banks such as Standard Chartered will remain non-centrally cleared for some considerable time.

- Many emerging market legal regimes do not support either netting or market standard collateral arrangements. Consequently, until such time as legal regimes in these jurisdictions provide the necessary legal certainty - both when receiving collateral and posting it - it will not be possible to comply with the proposals. Furthermore, any obligation to post collateral to counterparties in such jurisdictions will create greater systemic risk because collateral will not be protected upon the counterparty's insolvency.

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- Emerging markets-focused banks such as Standard Chartered have built business models around their strength in understanding and managing the various types of risk related to dealing with counterparties in those markets. In accordance with existing risk management practices, credit lines may be extended without any obligation for the parties to exchange collateral, a practice entirely consistent with the credit intermediation function of a bank. Additionally, there already exist stringent capital requirements in relation to those transactions, with proposals to strengthen them further with the Credit Value Adjustment (CVA) capital add-on proposals in Basel III. Any requirement that would mean we have to start exchanging collateral would therefore, including for the reasons following, significantly impact our business - not least in terms of considerable additional cost for our clients and material implications on market liquidity.

- Sourcing collateral in jurisdictions where repo and underlying government bond markets are less developed will add a significant cost to our business which will have to be passed back to the client, and will in many cases impact the viability of our business model. Similarly, any obligation on our counterparties in these markets to post collateral to us will substantially add to their own costs – even assuming they are willing to do so in markets that may not be subject to the proposed rules.

- While we applaud Principle 7 on consistent application across all jurisdictions, we believe this is unlikely to happen, at least in the short to medium term. Given the number of jurisdictions in which Standard Chartered operates, and the even greater number of regulators across those jurisdictions, any inconsistency or duplication in the application of the proposed rules will have a disproportionate impact on our business.

- Upon execution of an uncleared OTC derivative transaction with a counterparty in an emerging markets jurisdiction, a bank such as Standard Chartered may, in order to hedge the risk, enter into a related back-to-back trade with its London head office and/or a cleared trade with a CCP such as LCH. Each of these trades requires collateral. Any collateral taken in the emerging market country is unlikely to be eligible for the major CCPs/exchanges or isolated in the jurisdiction and unable to be employed to cover these related positions. In addition, given that repo markets are less developed, local government bonds taken as collateral cannot, without significant cost, be converted into a currency such US Dollars eligible as collateral for the hedging trades. Furthermore, local regulations are likely to limit the extent to which local collateral, including the local currency, can be converted to an eligible currency and moved offshore. This additional cost of hedging will have to be factored into the price of transactions and passed back to the end user client, and may outweigh the benefit of doing the trade in the first place. There is a risk that end user clients would, as a result, choose not to transact and leave their risks unhedged, resulting in an impact on the real economy.

We would urge regulators to take these points into consideration when drafting the final rules.

Our detailed responses to the consultation questions are in the attached Appendix. Our comments and suggestions are largely a reflection of our relatively distinct concerns. Above all, we believe that transactions with counterparties in jurisdictions that do not have the laws that support the enforceability of netting and/or market standard collateral arrangements should be exempt. We are not convinced that alternative solutions are possible in this instance, as any requirement to post and collect margin to and from those jurisdictions would lead to an increase in systemic risk. Similarly, transactions across jurisdictions that have not yet adopted the proposals should be exempt for the time being or made subject to transitional provisions.

However, this should not underestimate the extent to which we share some of the more general concerns expressed by the industry. In particular, there seems to be a real risk that the liquidity

shock of simultaneously applying the rules on mandatory clearing, margining and liquidity will be too great for the financial services industry but also for the real economy.

Phasing-in of the rules can be a part of the solution - this would allow sufficient time for any unintended consequences to emerge. Exchanging margin on a net rather than gross basis could be another consideration.

In addition, as the requirements are largely designed with the prudentially-regulated financial counterparties in mind, it would also be worth examining in more detail the relationship between margin and mandatory capital requirements. The two should be viewed as complementary, even if regulators believe there is a need to introduce both the 'defaulter pay' and the 'survivor pay' models. The results of the QIS should assist with this exercise.

Finally, exempting foreign exchange swaps and forwards is critical – these products are by their nature different from other derivatives, and are a part of an already well-functioning, deep and liquid market.

We would of course be very happy to discuss our response with you in more detail and help develop solutions that meet the policy objectives without creating an unlevel playing field or increasing systemic risk.

Please do not hesitate to contact me if you have any questions or require further information.

Yours faithfully,

Lenny Feder
Group Head, Financial Markets

Appendix

Q1.

i) What is an appropriate phase-in period for the implementation of margining requirements on non-centrally-cleared derivatives?

The proposals come alongside other significant initiatives in the OTC derivatives markets – in particular the implementation of central clearing for certain standardised transactions and increased capital requirements under Basel III for both cleared and non-cleared transactions – and, as such, are expected to have a significant impact on the industry. Market participants will require a sufficiently lengthy period of time in which to assess the implications of this latest proposal.

The phase in period must also take into consideration and address the complexities of implementation across all the major financial markets, not just those in the West. Regulators across all the jurisdictions must have the opportunity to fully consider and address the implications of the proposals, including:

- Laws and regulations in many jurisdictions do not fully support the enforceability of the netting and collateral arrangements required to support the proposals and will need to be either modified, or exemptions made accordingly;
- Distortions will arise where some jurisdictions adopt the proposals but others do not. Transitional arrangements must therefore be established to ensure a level playing field when counterparties in jurisdictions subject to the new proposals deal with those in other jurisdictions who are not;
- The interconnection between capital treatment for counterparty risk and the impact of the proposed additional margin (both initial margin and variation margin) requirements, need to be fully analysed to ensure the margin proposals are not duplicative and are, in any event, proportionate to the stated policy aims of reducing (not eliminating) counterparty risk;
- The impact on liquidity from the proposals is expected to be significant which, when combined with the central clearing and Basel III capital and liquidity regulatory initiatives, is likely to be amplified;
- If initial margin is required, models and standardised tables used to determine it must be approved by regulators in relevant jurisdictions, not just those in the West, and adopted by market participants in those jurisdictions;
- While western jurisdictions, particularly the US and those in the EU, are well advanced in their implementation of the central clearing initiatives, law makers and regulators in other jurisdictions are not. Time is therefore needed to establish central clearing in all relevant markets in a manner consistent with International standards before the margin proposals come into force;
- Synergies between CCP rules and non-cleared activities in order to remove any possibility of regulatory arbitrage.

In addition, all firms will have to undertake significant infrastructure work including:

- Developing initial margin (IM) models and having them approved across all markets;
- Executing all required contractual documentation, including ISDA Master Agreements and Credit Support Annexes (CSAs), with counterparties who previously did not have such documentation; or renegotiating documentation for those counterparties who do have it in order to provide for the new margin requirements;
- For firms that do not have existing collateral management systems, they will need to build the required infrastructure; and for firms that do, they will need to significantly enhance it in order to be able to manage the increased number of counterparties and calculate and handle IM.

ii) Can the implementation timeline be set independently from other related regulatory initiatives (e.g. central clearing mandates) or should they be coordinated?

The reform of derivatives markets consists of several linked components, each with the underlying aim of encouraging and incentivising central clearing as a means of reducing counterparty risk and enhancing the resiliency of the financial system. As a result, the introduction of mandatory central clearing, increased capital charges for both cleared and non-cleared derivatives, and the proposed margin requirements cannot be viewed in isolation. All of them in combination will have a profound impact on the market, and sufficient time should therefore be allowed for market participants and market infrastructures (such as CCPs and trade repositories) to comply with the new rules. It is essential that the different regulatory initiatives are coordinated.

iii) If coordination is desirable, how should this be achieved?

We believe that it would be extremely difficult and possibly detrimental to the stability and liquidity of the market to implement simultaneously all the components of the regulatory reform. In particular, the deadline for mandatory central clearing is driven by the G20 commitments to finalise the rules by the end of 2012, while some of the other proposals are still in their infancy. Also, and more importantly, the combined effect of central clearing, capital and margin proposals is likely to pose a liquidity shock to the market if implemented at the same time.

Phasing in will therefore be necessary, and our view is that mandated central clearing should be followed in due course by the implementation of the Basel III capital requirements. Margining of bilateral trades should be tackled last, allowing enough time for the other proposals to bed down, and for any unintended consequences to emerge. We would in particular be concerned by any threats to financial stability that could emerge from concentrating risk in CCPs, which we describe in more detail in our response to Q4.

Finally, proposals to provide margin in relation to transactions with counterparties established in jurisdictions that have not implemented the proposals but intend to do so should be delayed until the proposals are fully implemented in those jurisdictions. Without such a transitional regime or a temporary exemption, there will not be a level playing field potentially undermining the effectiveness of the proposals.

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?

FX swaps and forwards should be exempted from the margining proposals for the reason that existing practices in relation to these products already appropriately mitigate risk.

We are aware that various industry bodies support an exemption for all FX swaps and forward products based on, among other factors: (i) the primary risk of these products is settlement risk which is significantly mitigated through the use of the Continuous Linked Settlement (CLS) system and other bi-lateral settlement risk mitigation techniques, (ii) the transfer of margin unnecessarily adds settlement risk, (iii) the need for consistency with the exemption for such products proposed by the US Department of the Treasury under both central clearing and swap related margin regimes, (iv) tenor limits may serve to create artificial accumulation of risk just below the stated tenor threshold, (v) while these products are traded bi-laterally, they involve the physical settlement of separate currencies and are therefore not like derivatives which involve financial settlement in amounts determined by reference to an underlying reference or index, and (vi) these products are an essential part of the already well functioning, highly liquid FX market which may be undermined by the proposed margining requirements. Standard Chartered as a provider of foreign exchange swaps and forwards to its customers supports an exemption on these grounds.

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?

Exemptions should not only be product driven, but also take into consideration the impact on end users, the expected impact on liquidity and jurisdictional concerns.

While we note that the proposals do not extend to non-systemic entities, including non-systemic corporate counterparties, they will nevertheless impact the cost and availability of derivatives to all end users (systemic or otherwise). Transactions that hedge risks may become too expensive to execute, resulting in an impact to the real economy. Genuine hedging transactions, at least those with non-financial entities, should therefore be excluded from the proposals.

The impact on liquidity is addressed at Q4(ii). To the extent that exemptions can be created to lessen what is expected to be a significant burden on the OTC derivatives market and the economy as a whole, we suggest that the supervisors find solutions to lessen it.

As outlined in the answer to Q1(i), there are "jurisdictional" concerns that may require exemptions from the proposals in their current form, in particular in relation to: (a) jurisdictions that do not have the legal and regulatory regimes supporting the proposals, in particular jurisdictions where there is insufficient legal certainty in relation to enforceability of netting and rights to collateral; and (b) jurisdictions that do not adopt the proposals such that there will not be a level playing field when dealing with counterparties established in those jurisdictions.

Q4.

i) Is the proposed key principle and proposed requirement for scope of applicability appropriate?

We believe that the proposal should be limited to financial institutions only. Non-financial counterparties should be exempt. Moreover, the exemption for non-financials should not be limited to those that are non-systemic. This is for several reasons.

First, there is no globally-accepted standard or methodology for determining which non-financial firms are systemic and, even if one were to be developed, it is not clear who would enforce it and how. Second, we do not as a matter of principle believe that singling out some firms for a different treatment – whether financial or non-financial – is the right way to ensure that systemic risk is mitigated. Finally, requiring banks to take margin for trades with corporates is in effect disintermediating banks from distributing credit to such firms. An individual institution (such as Standard Chartered), which has specific expertise in emerging markets is better than other less expert institutions at calibrating its risk appetite as part of its credit intermediation function and should be free to choose whether margin is necessary. Consequently, it should be permitted to enter into agreements and transactions within their own internal policies and guidelines. The proposals should clarify that any transaction to which a non-financial firm is a party are exempt.

In addition, and as already mentioned, the scope should not extend to transactions with counterparties established in jurisdictions where netting and rights to collateral are not legally enforceable. In particular, requiring firms to post IM to counterparties in such jurisdictions would increase systemic risks (in that such margin may be at risk thereby compounding potential losses rather than mitigating them), as well as increasing risks for the individual institutions. The legal right to retain and apply collateral received from counterparties in such jurisdictions is also uncertain, and is therefore unable to be accorded any offsetting value.

ii) Does it appropriately balance the policy goals of reducing systemic risk, promoting central clearing, and limiting liquidity impact?

Margining can reduce systematic risk but only in jurisdictions where the legal framework supports such risk mitigating techniques. As stated above, where this is not the case, mandating collateral arrangements could mean an increase in systemic risk – posting collateral, particularly IM, would mean it may not be recovered; and collecting it does not guarantee protection upon a counterparty's default.

We would also point out that the CCPs themselves are likely to become systemic when central clearing becomes mandatory and incentivised by capital charges on bilateral trades. This is something regulators have themselves acknowledged – for example, the UK HM Treasury is currently consulting on resolution of CCPs (and other non-bank entities), and we understand the EU consultation on the same subject is imminent.

Concentrating risk into the CCPs is meant to be mitigated by a combination of IM and VM, as well as default funds and the CCPs' own capital. Also, Basel III levies an additional capital levy of 2% on counterparties for any CCP activity. The combination of additional collateral for clearing activities and the imposition of bilateral margining will have a significant drain on collateral in a market where stresses on collateral are already prevalent. Demand for high quality collateral is going to increase as other regulatory initiatives, such as Basel III, are implemented. The costs associated with sourcing collateral will be passed back to the end user. For some, unless they are made exempt, they will prove too expensive and they may withdraw from these activities altogether. This would increase economic risk, even if systemic risk is minimised. As outlined in

our cover letter, this impact will be particularly acute in many of the jurisdictions in which Standard Chartered operates.

iii) Are there any specific adjustments that would more appropriately balance these goals?

As outlined earlier in our response and in our cover letter, we believe that the proposals will have a disproportionate impact on our business and our customers. The expected costs of the proposals (not least in terms of liquidity impact) arising in all jurisdictions must be carefully weighed against their benefit. Given the other regulatory initiatives currently being rolled out across the industry, we suggest that the margin proposals be tackled last, allowing enough time for the other proposals to bed down, and for any unintended consequences to emerge.

iv) Does the proposal pose or exacerbate systemic risks?

In addition to the expected liquidity shock and the impact on the real economy as hedging costs inevitably increase, systemic risk will be increased to the extent collateral, particularly IM, is posted to counterparties in jurisdictions where it is not protected by local law.

v) Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

In jurisdictions whose legal regimes do not support the enforceability of netting and collateral arrangements, these proposals are essentially unworkable. In jurisdictions that do support these concepts, but where there is no collateral market in which to source and re-hypothecate the collateral, the liquidity impacts will materially affect the pricing of derivatives.

In addition, within the developed markets, the development and regulatory approval for IM and VM models will be time consuming. Within firms, significant development of collateral management systems and infrastructure will be essential in order to be able to calculate and manage IM and ensure it is appropriately segregated in order to prevent its re-hypothecation or co-mingling with a firm's own assets.

Consideration must also be given to the time taken to renegotiate existing CSAs and to execute new CSAs with counterparties who had not previously been required to post or collect collateral. The burden of these changes should not be underestimated.

As stated in our response to Q1, these considerations must be addressed before the proposals can be implemented.

Standard Chartered

Q5.

i) Are initial margin thresholds an appropriate tool for managing the liquidity impact of the proposed requirements?

We do not agree with the proposal requiring firms to hold IM to cover exposure in relation to any bilaterally executed non-cleared derivatives transaction. It should be left up to individual institutions to decide the extent of uncollateralised exposure they are prepared to offer their counterparties and to set any trigger point which leads to the transfer of IM. The current and proposed capital charges (for prudentially regulated institutions) in our view already provide sufficient protection in relation to the exposure between counterparts and this balance should be left to the decision of the two parties to the trade.

ii) 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?

Thresholds for either IM or VM should be agreed between two individual firms, taking into consideration credit appetite and the capital levied of counterparty exposure.

iii) Is the use of thresholds inconsistent with the underlying goals of the margin requirements?

While thresholds for IM should alleviate some of the liquidity concerns that the sudden and wholesale imposition of IM will create, we do not agree with the proposal to mandate margin IM for bi-laterally executed non-cleared derivatives.

iv) 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?

See our answers to Q5(i)/(ii).

Q6.

i) Is it appropriate for initial margin thresholds to differ across entities that are subject to the requirements?

As stated previously, IM and VM triggers/thresholds should be decided upon between two individual institutions and as such, depending upon the expertise and credit appetite IM and VM thresholds are bound to vary.

ii) 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?

As stated previously, this should be a matter for individual firms to decide, taking into consideration credit appetite and availability of capital.

iii) 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?

The imposition of thresholds should take into consideration the possible effects of the availability and cost of collateral, ability to enforce rights to collateral, along with credit quality of counterparts and any potential correlation or one-way risk when deciding upon IM and VM trigger points. These trigger points/thresholds will by definition be different across jurisdictions and counterparties, and should be set by individual counterparties in order to ensure a level playing field is maintained between market participants.

iv) Can an entity's systemic risk level be meaningfully measured in a transparent fashion?

Only by looking at the value at risk (VAR) or capital consumed by the derivative activity can risk in relation to the derivatives trading activity be measured (albeit the limitations of VAR should be borne in mind especially if the input period has been benign). Disclosures under the current capital regime include information on the constituent parts of market risk capital which will indicate the amount of capital held in respect of certain types of activities.

v) 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?

The Financial Stability Board has set out a framework to capture whether an entity is deemed to be systemically important based on a number of inputs. However, this is only is respect of the organisation in totality rather than for certain activity types. As stated above, the relevant risk in respect of derivatives activity can be measured by looking at the VAR or capital consumed by a single entity within a specific jurisdiction.

vi) Could data on an entity's derivative activities (eg notional amounts outstanding) be used to effectively determine an entity's systemic risk level?

The notional amount of transactions transacted (observed over particular time periods and at particular points in time as a proportion of the overall market) together with the number of counterparties an individual institution has executed transactions with, are used as indicators of liquidity and participation. However, only VAR and capital utilisation can be used to estimate the relevant risk of any given individual institution in respect of derivatives activity, although the limitations of VAR should be noted.

Q7.

i) 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?

As stated above, we do not agree with the proposal requiring firms to hold IM to cover exposure in relation to any bilaterally executed non-cleared derivatives transaction.

However, should regulators wish to require IM for some market participants, we note that prudentially regulated entities are already subject to stringent capital requirements as a form of credit mitigation. The introduction of the Credit Value Adjustment (CVA) capital add-on will add additional protection (albeit CVA is not appropriate for all counterparties or markets and transactions with corporate counterparties in particular should not be subject to it). Imposition of IM and VM across all counterparts and transactions when combined with capital charges will in effect lead to a form of “super-protection”.

We believe that instead, banks should have the right to choose between a capital charge or IM and VM, and not both. The consequences of “super-protection” will lead to a very high increase in costs for the end user, which will lead some to cease hedging and risk management, impact transaction volumes, and therefore ultimately have a negative impact on the real economy. As stated above, we believe this impact will be particularly acute in many of the jurisdictions in which Standard Chartered operates.

ii) 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?

The proposal specifies that the intention is to limit regulatory arbitrage and create a level and consistent playing field. Limiting the scope to prudentially regulated entities defeats these intentions.

Q8.

i) How should thresholds be evaluated and specified?

As stated previously, we do not agree with the proposal to mandate IM. It should be left up to each party to a transaction to decide the extent of exposure it is prepared to offer its counterparties. Likewise, threshold levels should be calculated by the parties based on their respective evaluations of counterparty risk, the terms of the transaction(s) and the type and liquidity of collateral offered.

ii) 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? Are there other methods for evaluating thresholds that should be considered? If so what are they and how would they work in practice?

This will largely depend on the types of institutions, products, markets, available collateral and legal framework. Two large FI’s in the developed markets should have developed similar (and

regulatory approved) models and, depending upon the credit appetite, will set IM and VM (including thresholds) accordingly.

Where two institutions have wildly differing models, including where one is using the standardised tables to determine the IM it will demand, these proposals mean that these two institutions may never agree on the amount of IM for any portfolio of transactions.

If regulators wish to require IM, we urge them to further consider this asymmetry and to permit time for IM models to be developed and tested for use by covered entities.

Q9.

i) 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?

Estimating the amount of collateral required across all institutions is problematic and is bound to lead to wildly differing estimates depending on the assumptions used. Some recent estimates indicate up to tens of trillions of USD-worth of liquid collateral would be required to support these initiatives in a market where the existing pool of eligible collateral is already being squeezed. Banks subject to additional capital requirements to cover liquidity risk under Basel III are already hoarding high quality liquid assets as inventory. Collateral is already scarce and as such very expensive. To the extent rehypothecation of collateral would be prohibited under the proposed rules, the market would be further drained of liquidity. Achieving full segregation regarding cash is more complex (than for securities), further pushing collateral towards those increasingly scarce high quality securities.

For institutions such as Standard Chartered there are other considerations to be factored in. Upon execution of an uncleared OTC derivative transaction with a counterparty in an emerging markets jurisdiction, we may, in order to hedge the risk, enter into a related back-to-back trade with our London head office and/or a cleared trade with a CCP such as LCH, which each require collateral. Any collateral taken in the emerging market country is unlikely to be eligible for the major CCPs/exchanges or isolated in the jurisdiction and unable to be employed to cover these related positions.

In addition, given that repo markets are less developed in emerging markets, local government bonds taken as collateral cannot, without significant cost, be converted into a currency such US Dollars eligible as collateral for the hedging trades. Furthermore, local regulations are likely to limit the extent to which local collateral, including the local currency, can be converted to an eligible currency such as US Dollars and moved offshore. This significant additional cost of hedging will have to be factored into the price of transactions and passed back to the end user client - and may outweigh the benefit of doing the trade in the first place. There is a risk that end user clients would, as a result, choose not to transact and leave their risks unhedged, resulting in an impact on the real economy.

As stated in answers to Q1-Q4, we also remain concerned that any requirement on Standard Chartered to post margin (particularly IM), to counterparties in jurisdictions with legal regimes that do not provide the necessary protection to that margin, including upon the counterparty's insolvency or default, will increase in an unacceptable manner.

ii) How would universal two-way margining alter current market practices and conventions with respect to collateralising credit exposures arising from OTC derivatives?

The sourcing and subsequent management of collateral may be impossible for some counterparts and for others become prohibitively expensive thereby resulting in some counterparts withdrawing altogether from the derivatives market, leaving some risks unhedged and resulting in impact on the real economy.

iii) Are there practical or operational issues with respect to universal two-way margining?

Efficient collateral management is a core part of these proposals. Realistically, only large financial institutions are equipped to manage the complexities involved. Consequently these proposals run the risk of excluding a number of the end users who currently participate in the derivatives market for risk management purposes.

As stated previously, we are particularly concerned about the proposals in jurisdictions where the legal framework does not support the enforcement of netting and collateral enforcement.

Furthermore, new obligations on counterparties to collect IM and segregate it is a new line of business that many have not previously had to undertake. Such obligations will add additional costs and exposures that they may not be able to absorb. To the extent that third party custodians are required to fulfil these obligations, such arrangements may in many of the jurisdictions in which we operate be very onerous or simply not possible to establish. There may be no suitable custodians in the jurisdiction and/or local laws may not support the safe custody of client assets as contemplated by the proposals.

Q10.

i) 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?

ii) Does this specific requirement reduce, create, or exacerbate systemic risks?

Requiring prudentially regulated entities such as Standard Chartered to post IM to unregulated counterparties is undesirable and does not reflect the principle stated in the consultation paper of enhancing systemic resilience. As previously stated, requiring such entities to post IM as well as set aside capital creates a regime of “super protection”, places a disproportionate strain on liquidity, including during times of market stress, and introduces new and unintended risks, particularly in jurisdictions where laws do not protect IM posted.

We also note the “gross” nature of the IM requirements which we do not agree with. To the extent parties are encouraged to post IM, it is important that IM models permit netting across the portfolio of transactions executed.

iii) Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

See response to question Q9(iii) above.

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

For the reasons stated at Q4(i), exemptions for non-financial entities that are not systemically important need to be widened to include all transactions with non-financial entities, across all jurisdictions. Without this exemption corporate and other non-FI entities which use the derivatives markets to manage risk efficiently are likely to be completely excluded due to their inability to raise and manage collateral

The specific exclusion for sovereigns and central banks should be reviewed in the light of the European sovereign debt crisis.

Adding further asymmetry into margin arrangements among financial institutions only serves to exacerbate systemic risk.

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?

In addition to the exemptions outlined above, we believe intra-group transactions should be exempt from both the VM and IM margin proposals.

This is because intra-group liquidity management practices and regulatory considerations have to be taken into consideration: any regulators (including the FSA) stipulate and enforce strict intra-group lending limits between group and subsidiaries. Intra-group collateralisation of exposures can be mitigated by securing the exposure, either via repurchase agreements or by collateralising derivative exposures. However, some emerging market jurisdictions prevent the free flow of local currencies and local currency denominated bonds, in which case the exchange of collateral between group entities is not possible.

We therefore support any exemption from the requirement for group entities to exchange variation margin, and ask that the “specific criteria” outlined in the consultation document be further clarified, particularly the requirement that “*there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities between the entities”*.

Q13.

i) Are the proposed methodologies for calculating initial margin appropriate and practicable?

We reiterate our submission that we do not agree with the proposal to mandate IM for bilaterally executed non-cleared derivatives.

To the extent that IM is encouraged, any proposals will only work where participants have similar levels of sophistication and operate in the same markets with broadly the same IM models. This level of consistency will only therefore be appropriate within the inter-dealer community within the very liquid G3 currencies, collateralised in G3 government bonds. Outside of these instances, the variances between the numerous participants, markets and available collateral could have a number of consequences, including a virtual inability to ever agree the amount of IM to be delivered.

ii) 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?

To the extent IM is required, models to calculate it must take into consideration the effect of netting and any diversification benefits across products and deliverable currencies in a broadly similar fashion to the methodology employed by CCPs in existing major Western financial markets. While models such as IMM may be appropriate for the inter-dealer communities transacting in G3 currencies, such sophisticated modelshave to date been unavailable for emerging markets participants. This has resulted in difficulties, as outlined in our answers to previous questions.

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?

Restricting diversification is counter-intuitive to managing systemic risk. A more diversified portfolio of exposures and products for any given counterparty is less risk-sensitive than a less diversified portfolio.

Q15.

i) With respect to the standardised schedule, are the parameters and methodologies appropriate?

While we do not agree with the proposals to exchange IM, in order to promote consistency and prevent any regulatory arbitrage, the standardised schedule should follow closely the collateral requirements set by local approved CCPs. Where there is no such CCP, local trade associations could work closely with the local regulator achieve a workable schedule.

However, there is no clarity within these proposals to address potential issues where one counterparty is bound under these proposals and the other is not obligated to follow them. This needs to be clarified.

ii) Are the initial margin levels prescribed in the proposed standardised schedule appropriately calibrated?

Please see our response to the previous question.

iii) Are they appropriately risk sensitive?

In order for IM to achieve its risk mitigating goals, it has to take into consideration all products that are executed under the collateral agreement. Without this, managing IM at a product level will result in a massive increase in potential disputes and further collateral management complexities.

iv) Are there additional dimensions of risk that could be considered for inclusion in the schedule on a systematic basis?

Please see our response to 15(iii).

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?

We broadly support the proposed methodology for calculating VM, noting in particular the netting and diversification benefits inherent in the calculation methodology. While the calculation of IM is different (in that it captures future as opposed to current exposure), we believe VM and IM should both take into account the offsetting nature of trades within a portfolio to the extent those trades are covered by an enforceable legal arrangement such as s netting agreement.

Q17.

i) With what frequency should variation margin payments be required?

Where possible VM should be calculated, called and transferred within one business day, or within the shortest period possible taking into consideration the settlement procedures within any given specific jurisdiction.

ii) 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?

There are some instances where less frequent posting may be acceptable such as:

- Clients who are unable to cope with daily margining and are prepared to over-collateralise or provide deep haircuts for eligible collateral;
- Specific collateral which may require deeper haircuts, which despite being relatively stable in terms of price action, may not have sufficient liquidity to be able to be liquidated in sufficient timeframe;
- Esoteric collateral such as letters of credit or guarantees which may be applicable as collateral in some markets as the only form of collateral and by their very nature have limited liquidity, necessitating larger haircuts and negating the need for daily margining,

Q18.

i) Is the proposed framework for variation margin appropriately calibrated to prevent unintended procyclical effects in conditions of market stress?

VM should be managed depending upon the credit appetite between two entities, taking into consideration changing market conditions, available liquidity in the underlying product and availability of suitable collateral. Enforcement of pre-set and rigid VM triggers will restrict liquidity in the underlying product and aggravate pro-cyclicality during periods of market stress.

ii) Are discrete calls for additional initial margin due to “cliff-edge” triggers sufficiently discouraged?

IM and models should take into account changing market conditions and adjust accordingly, rather than follow a pre-defined standardised approach applicable to all participants. Having one standardised set of rules for all participants will increase pro-cyclicality.

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

The intention of VM is to minimise uncollateralised exposure but also taking into consideration settlement procedures and deadlines as well as minimum transfer amounts for eligible securities. Where practically possible, VM should be called daily and a Minimum Transfer Amount (MTA) somewhere between $50,000 -> $100,000 (or the equivalent thereof).

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

The proposed eligible collateral schedule and haircuts are far too restrictive given the potential scope of these proposals and taking into account that they are meant to be implemented across a number of markets at different stages of development.

Eligible collateral for the standardised schedule should mirror the trading and liquidity conditions for all markets where these proposals will be implemented. As such, the list should include the eligible collateral specified by any approved CCPs in the specific jurisdiction. Where there is no such CCP, the eligible collateral should be expanded to include local currency government (and agencies) paper that is eligible to be delivered into the respective local central bank to source funding; the local currency; shares of issuers included in any local major liquid equity indices; corporate bond issues from major local corporates and banks; and gold.

Q21.

i) Should concrete diversification requirements, such as concentration limits, be included as a condition of collateral eligibility?

Having a diverse pool of eligible collateral will be beneficial from a risk and liquidity management perspective. However, many CSAs (in particular English law CSAss) do not allow mandatory substitution of collateral without consent and, unless this is changed, maintaining a diverse pool will be virtually impossible to implement.

Furthermore, within jurisdictions where collateral is limited with regards overall eligibility and availability, maintaining any form of diversity will also be problematic and impractical.

ii) If so, what types of specific requirements would be effective?

Any form of diversification should be based around the availability and liquidity of eligible collateral. Creating diversity rules shoud take into consideration the overall profile of the exposures and instruments, and include currency and duration of collateral as well as correlation between counterparty sector and collateral issuer.

iii) 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?

As previously stated the standardised haircut schedule is far too restricted. In addition, the haircuts proposed are far too generic and conservative. These need to be re-assed, especially in the context of emerging markets and cross-border risk management.

iv) Are there additional assets that should be considered in the schedule of standardised haircuts?

Please see our response to question 20.

Standard Chartered

Q22.

i) Are the proposed requirements with respect to the treatment of provided margin appropriate?

Segregation of IM will only provide protection where the legal jurisdiction allows. This proposal does not address instances where one counterparty is posting into a jurisdiction which does not support segregation (irrespective of whether the legal framework supports netting and collateralisation).

ii) 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?

Segregation should be an option which is negotiated and agreed between the two counterparts, taking into consideration the ability to enforce the rights of the non-defaulting counterparty to retrieve its collateral without a lengthy legal process.

iii) Is the proposed key principle and proposed requirement adequate to protect and preserve the utility of margin as a loss mitigants in all cases?

Only where the legal framework supports the non defaulting counterparty by protecting collateral posted and taken. In addition, the custodians that are able to support such account management should be of sufficient credit worthiness not to have a material capital impact on the counterparty posting collateral.

Q23.

i) Is the requirement that initial margin be exchanged on a gross, rather than net basis, appropriate?

The ability to net exposures is a critical element of risk management used throughout the financial markets in jurisdictions which have a legal framework which supports this concept. This practice should continue.

ii) 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?

Within the developed markets, IM is likely to be concentrated within the major custodian banks who have the capability to support the complexities involved. This will have the effect of concentrating pools of collateral in a limited number of large institutions.

Within the emerging markets there is the potential for this risk to be even more concentrated given the dependence upon the major western banks for custodial services. Please also note our comments at Q9(iii).

Q24.

i) Should collateral be allowed to be re-hypothecated or re-used by the collecting party?

Re-hypothecation of securities and re-use of cash collateral should be permitted in jurisdictions which have the legal framework which can support such activities. Inability to reuse collateral will have a direct impact on pricing of the derivative and on the total number of transactions in that market.

In addition, any restriction will also impact the overall capacity for banks to transact because of the liquidity issues that this would present. For emerging markets where the available pool of collateral relatively small and the collateral markets themselves still illiquid, the inability to re-hypothecate or re-use cash collateral will exacerbate the issue further, resulting in illiquid markets and uneconomical pricing.

More fundamentally, it would seem perverse that regulation simultaneously requires highly liquid and high quality assets to be used as collateral while immobilising the assets possessing these features.

ii) 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?

Segregation of collateral is already addressed in response to Q22. In addition, having segregated collateral pools for each and every client will complicate the operational complexities of managing the entire process. A lot of the efficiencies now treated as standard practise would be reversed.

Q25.

i) Are the proposed requirements with respect to the treatment of non-centrally-cleared derivatives between affiliated entities appropriate?

As discussed previously, inter-affiliate trades should be excluded from these proposals. Intergroup exposures and liquidity management are already governed by limits and liquidity guidelines set by local regulators. In addition, some jurisdictions prevent cross-border mobilisation of collateral, making inter-affiliate and inter-entity posting of IM and VM physically impossible.

Please also note our response to Q12.

ii) 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?

Please see our response above.

In any case, local regulators will set IM based on the liquidity of the respective bond and cash markets. It is somewhat unlikely that all regulators will set haircuts for the domestic and international debt at the same levels, and consequently regulatory arbitrage is a distinct possibility. This will be exacerbated within some markets where the legal framework does not support the free movement of inventory, or where the legal framework does not support collateralisation.

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?

Please see our responses to Q12 and Q25.

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?

Regulators need to interact in order to develop these proposals in a manner which does not lead to wholesale regulatory arbitrage, decrease in liquidity including overall funding liquidity, and increase in costs for the end users.

Regulators must also address the problems inherent in cross-border transactions where the legal regime in a jurisdiction does not support collateralisation. If these issues are not addressed, then the end user is liable to see a material decrease in the number of counterparts which could, in turn, end up concentrating risk with local banks rather than having a diverse spread of participants. This would lead to a decrease in liquidity and product availability, and an increase in costs.

As previously stated, it is very important that these proposals are considered and timed along with the implementation of other liquidity and capital regulatory changes, and in a consistent manner across all markets, to the extent that this is possible.