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Ladies and Gentlemen:

Re: Second Consultative Document: "Margin requirements for non-centrally cleared derivatives"

This submission relates to the Quantitative Impact Study (the "**QIS**") whose results are summarised in Appendix C of the Consultative Document referred to above. It is made on behalf of the five Australian banks named below (the "**Group**" or "**We**") in our role as market participants and liquidity providers, and reflects a common view on the process around the QIS and the impact of initial margin in the Australian context.

Each member of the Group contributed their own data to the study and in each case the modelled worst case was the standardised initial margin schedule and would result in the Australian Banking system being required to post in the order of USD 250 to 300 billion of initial margin. In the lowest initial margin outcome where full portfolio offsets were available, we would expect the Australian Banking system to be required to maintain a gross initial margin pool of USD 30 to 40 billion (prior to reduction as a result of the application of thresholds, with the level of the reduction of course dependent on various factors).

The Group notes that while Australia has one of the largest pools of retirement savings anywhere in the world, the allocation to fixed income is among the lowest. This has created a structural requirement for Australian Banks to tap offshore capital markets and swap the proceeds back to the local currency.

The most influential product contributing to the enormous initial margin requirement for the Group in aggregate is cross currency swaps, which were classified as "foreign exchange swaps and forwards" for the purposes of the QIS. More generally, any interest rate swap that included more than one currency was regarded as a foreign exchange derivative for the purposes of the QIS.

Cross currency swaps are not akin to outright forward foreign exchange transactions as they bear intermediate cashflows and are largely rebased on a quarterly basis to reflect the current exchange rate.

The Australian banking system has a significant requirement for this product, which would be severely impacted by the potential requirement for both parties to post initial margin. For every USD 1,000 million issued by an Australian bank, the global system will absorb approximately USD 160 million of initial margin based on current assumptions of volatility and confidence intervals (acknowledging that this does not include a reduction for offsets, where permitted).The QIS survey did not survey the losses due to default that had been experienced by contributors. We believe that the circumstances that led to large derivative related losses in other jurisdictions have never been experienced in Australia and would be unlikely given the regulation and nature of our businesses. Our realised losses from derivatives cumulated over the past 10 years would be unlikely to represent as much as 1% of the anticipated lowest case initial margin.

The members of the Group have two main concerns about the imposition of initial margin requirements on Australian cross-currency swap transactions:

1. The quantum of margin required we expect would have significant systemic implications for the Australian banking system, which adverse impacts are probably shared by very few other economies, and which we believe ought to be considered carefully by the Working Group.

2. The amount and cost of the margin taken from the Australian banking system due to cross-currency swaps does not seem at all justified when it is assessed against: (i) the risk of future losses; and (ii) historic losses, on cross-currency swap transactions, and the ability of Australian banks to absorb them.

The view of our Group is that the QIS data require a qualitative overlay that considers these two factors.

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