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March 15, 2013

Secretariat of the Basel Committee on Banking Supervision
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Secretariat of the International Organisation of Securities Commissions
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Re – Second Consultative Document : Margin Requirements for Non Centrally Cleared Derivatives (February 2013)

Ladies and Gentlemen,

Barclays appreciates the opportunity to comment on the above Consultative Document issued by the Working Group on Margin Requirements ("WGMR") of the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions.

The Second Consultative Document builds on the document issued by the WGMR in July, 2012 by selecting the universal two way option as the applicable scope of the initial margin requirement and retaining the 99% confidence interval over a ten day time horizon to determine the amount of initial margin to be posted. The high cost to market participants of these choices are mitigated by

(a) allowing a "phasing in" of the requirement over several years

(b) implementing a *de minimis* threshold below which the posting requirement would not apply

(c) introducing an option for participants to forego the first Euro 50 million of initial margin if they see fit to do so, and

(d) allowing a wide range of assets to be eligible as initial margin.

In this way the Consultative Document seeks to strike a balance between the policy objectives of assuring the systemic safety of the market at a cost that will not itself generate disproportionate risks that compromise attaining that objective. We support this goal but believe that further examination of how best to achieve that balance – and the calibraton of those means – is merited. Provided certain key elements are finalized, engaging in such further examination will not necessarily result in a deferral of the implementation date, since the market can commence building parts of the required infrastructure framework without needing to know the precise parameterization of the requirements.

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Cost Mitigants

We address issues relating to rehypothecation and the "phasing in" in the sections below that respond specifically to the questions raised by the WGMR. In addition, we have the following observations relating to the available options to reduce the cost to the market of the initial margin requirement while still achieving the policy objective.

(A) Allowing capital cost to play a greater role / reducing the dependence on liquidity cost.

In our comment letter on the July 2012 Consultative Document we expressed our view that an initial margin regime that mitigates risk by means of liquidity cost alone is relatively more expensive in meeting the policy objective than a framework that blends elements of both liquidity cost and capital cost. At the high levels of initial margin proposed in the Consultative Document, minimal incremental capital relief is obtained for a significant proportion of the "higher" levels of initial margin posted. At lower levels of mandated margin, capital plays a role also, allowing counterparties to flex between holding more capital on the one hand and posting/receiving more initial margin on the other. In this way a participant is able to maintain a diverse set of approaches which it can modify depending on the relative costs of liquidity risk (changes in funding spread, collateral availability) and capital risk (changes in cost of capital). The notion of the interplay between capital and margin is at the core of the BASEL III capital regime. We acknowledge the points made in the Consultative Document regarding the greater dynamic of margin but believe that there are benefits to having some portion of the core risk mitigation to be addressed though capital cost.

We urge the WGMR to reconsider the role that capital might play in cost reduction.

The permissibility of the Euro 50 million threshold for initial margin will allow for some rebalancing of the risk between liquidity cost and capital cost. We expect that this will result in many smaller clients not having to post any initial margin as a matter of regulatory mandate. For these clients dealers will have the option to absorb this credit risk though capital cost. We support this approach because it is consistent with the policy objective of focusing on the risks between larger market participants and recognizes that capital is particularly well suited to mitigating risk deriving from large numbers of clients who are diversified and highly unlikely all to default at the same time. As between dealers, however, it Is our expectation that overall posted initial margin levels will be so great under the proposed parameters that reliance on capital will still be minimal, even in the case where a dealer allows its dealer counterparty the benefit of the Euro 50 mm threshold. In this case larger thresholds would be required to allow capital cost to perform a meaningful element in addressing the overall risk. Our view is that this could be permitted consistently with achieving the policy objective.

Accordingly, we invite the WGMR to explore whether a figure other than Euro 50 million would result in a more optimal balance between liquidity and capital cost. There may also be merit in allowing a higher permitted threshold for different market participant types. More data is required to allow an informed assessment.

In this context, we do not believe that it is necessary to impose margin levels for uncleared swaps at higher levels than for cleared swaps simply to introduce an incentive to develop clearing capability for

uncleared swaps. That incentive already exists since the netting of risks against the single central counterparty is far more impactful in reducing overall posted margin than the margin differential between cleared and uncleared swaps. Basel III capital treatment also motivates the progression to clear. If is thought that additional inducement is needed, acceleration of the move to clearing could simply be achieved by mandating dates by which uncleared swaps need to clear.

(B) Ability to calculate initial margin requirements across asset classes

We support permitting risk offsets within certain limited parameters since the simple addition of the risks, without any recognition of correlation or diversification, can only result in a number that is overly conservative. We agree that correlations between asset classes are not as stable as those within a single asset class. However, prudent risk management normally involves holding more diverse portfolios with counterparties. Disallowing any degree of margin offset between asset classes fails to take account of this. In our opinion permitting these offsets within appropriate parameters is a way to reduce the margin cost without introducing unacceptable risk.

(C) Availability of unencumbered assets to be posted as margin

Widening the types of assets that may be posted to satisfy the initial margin requirement clearly will mitigate to some degree the cost involved. However, we urge caution against overstating this benefit since banks work very hard currently to engage in secured funding wherever possible. Assets that make up a bank's "Readily Available Assets" are not all available to be posted as margin. This figure, for example, includes the liquidity buffer and assets such as loans and advances to customers that, absent securitisation, fall outside the eligible margin definition.

(D) Currencies

An 8% haircut is proposed on cash collateral received in a currency other than the currency of the underlying transaction. The market today typically moves margin in a single currency for the whole portfolio. Margining in several different currencies would involve multiple daily margin flows depending on the number of currencies traded per client and increase operational and settlement risk between parties. An 8% haircut on each currency element within the portfolio, even when margin is moved in a single currency, will meaningfully add to the margin cost. We recommend that an assessment be made to determine the additional margin that would result from applying such a haircut and whether this is disproportionately high.

(E) Use of Models

As the WGMR acknowledges, in appropriate cases where netting is permitted by the relevant jurisdiction, the ability to use models for the quantification of the risk that the initial margin seeks to guard against is a critical element in reducing the overall cost to the market. This is evident from the QIS responses. Two points arise out of this -

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(i) In practice the initial margin regime should not be implemented until such time as these models have been approved for use by the regulators of the jurisdictions in which markets are active, and

(ii) In the case of a universal two way implementation of the mandate to post initial margin, it is to be expected that no participant will be willing to hold uncleared derivative risk to any counterparty who is requiring to receive margin calculated on the standard basis, except in limited cases of unidirectional risk or very small portfolios. Accordingly, a high proportion of market participants must have adopted approved models prior to implementation for their participant category. This requires an expeditious approval process. We urge the WGMR to give particular consideration to this in the phase in criteria and timelines.

Additional Issues / Risks

(A) Procyclicality

Use of thresholds of course increases the procycality risk, because any additional margin called for is a higher proportion of the margin already posted in the case where thresholds are permitted than when they are not. This procycality itself introduces a new a systemic risk. One is substituting credit risk with liquidity risk. Setting margin levels at high levels in the first place may allow for the mandate to include appropriate "dampeners" that address this risk. Options might include limiting the time series to reduce the impact of stress periods. Some form of "moving average" basis may be used to alleviate the sensitivity to new days being brought into the time series. Another option might be to cap the increase in margin as a percentage of the margin already posted over prescribed intervals. These methods erode the protection afforded but may be an acceptable rebalancing of the risks given the high level of protection that 99% confidence ten day period affords even in more stable market conditions.

(B) Use of thresholds on a consolidated group basis

The Consultative Document proposes to require thresholds to apply on a group wide basis. Although we understand the objective of this is to avoid the proliferation of thresholds across multiple legal entities in the same group, such an approach raises significant practical issues in implementation. Given that participants themselves track the credit risk to their counterparties both by individual legal entity and on a group wide basis, we believe that this issue can be more appropriately addressed though prudential oversight and risk management policies than specifically though the mandated margining regime. Anti avoidance measures are sufficient to deter inappropriate behavior. As crafted we expect that in order to alleviate practical issues participants will permit a threshold for only one entity in its counterparty's group.

We set out below our responses to the four specific issues on which the Consultative Document seeks input.

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Question 1

Physically settled FX Forwards

(a) **Should these be exempt from initial margin and have variation margin imposed only by supervisory guidance or national regulator?**
(b) **Should FX swaps with different maturities be treated differently?**

Barclays substantially agrees with the position expressed by the GFMA and FX Division in it's comment letter in response to the Consultative Document. We hold the view that an appropriate use of variation margin – even for physically settled forwards – may play a useful role in risk mitigation.

Question 2

Should re-hypothecation be allowed if customer assets are protected ?

We generally support the response to this question contained in the SIFMA comment letter to this Consultative Document—that the difficulty with ensuring full protection of posted initial margin absent incurring the cost of employing a third party custodian is relevant in the decision whether or not two-way initial margin should be a requirement of the margin regulation. We note that the industry worked through these problems several years ago in producing the Independent Amounts white paper (Release 2.0) on March 1, 2010 sponsored by ISDA, the MFA and SIFMA, which we believe contains a good summary of the balance of costs and benefits in choosing an appropriate structure for posting initial margin. Requiring full protection of posted initial margin removes the ability of a sophisticated financial entity to make its own judgment about what level of protection it wants to pay for and neglects the fact that for prudentially-regulated entities, this risk may also be protected against by increased capital requirements where posted initial margin is not protected in a counterparty default. We view this as particularly questionable where the financial entity posting the initial margin is not systemically significant and thus where there is no systemic stability justification for limiting that entity's options for determining the level of protection it is willing to pay for.

Question 3

Are the phase in arrangements appropriate ?

We agree with the deferral of the first implementation date until at least January 2015. In our view the market will need all of this time to put itself in a position to be able to comply with the requirements set out. Many dependencies in fact make this date a challenge, especially the need for the market to arrive at a common framework for models and risk parameters and the requirement to obtain model approvals in advance of implementation from a variety of regulators, which effectively necessitates the build to be completed in well advance of January 2015. Regulators themselves must have also have determined which national regulators treatment is 'consistent" with their own in order to apply the framework as set out in Element 7. As stated above, model recognition we believe to be central to the cost question, since any obligation to adopt the standard method may, in relation to many participants, raise liquidity costs to prohibitive levels.

The notional amounts which dictate the sequencing of participants becoming subject to the initial margin mandate seem arbitrary. No guidance is offered in the Consultation Document to justify the particular notional amounts chosen. We expect most major dealers would be required to implement the mandate by the January 2015 date, which we infer to be the intent. But as to the deferred categories we suggest a definitional approach be adopted that sequences the introduction of the mandate additionally by participant type rather than by solely outstanding notional. Participants need to know with as much certainty as possible when they are required to be ready to make margin calls of one another.

We support a *de minimis* exception but are unable to comment at this time on the relationship between the Euro 50 million threshold and the suggested Euro 8 billion notional below which exemption from the mandate applies.

We support the provision as set out that all covered participants must deliver variation margin by January 2015. We regard variation margin as singularly the most effective means of reducing systemic risk and accordingly, provided such margin can be re-hypothecatded, support the earliest and most widespread adoption of this aspect of the mandate as is achievable in practice.

Question 4

Comment on the accuracy and applicability of the QIS results discussed

We support the comments made in the SIFMA letter in response to the Consultative Document recognizing certain limitations in the data contained in the market's QIS responses.

Given that there is adequate time available before the prospective implementation date, we recommend a further QIS be conducted to provide the regulators with additional information to consider in determining the optimal calibration of the variables that drive the amounts of cost involved. This additional information will equip the WGMR to adopt a margin regime that meets the policy objectives with greater confidence that the associated costs and impact on liquidity align with these objectives.

We would be pleased to expand on any of these points or answer any questions you may have.

Respectfully,

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