Chris Barnard
Germany

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
baselcommittee@bis.org

11 March 2013

Your Ref: Comment letter on Consultative Document
- Margin requirements for non-centrally-cleared derivatives

Dear Sir.

Thank you for giving us the opportunity to comment on your consultative document on: Margin requirements for non-centrally-cleared derivatives. I have provided comments on your first consultation,[1] and I will not repeat all of my previous comments here. I support your key principles and requirements. I agree that the requirements should not impose margin requirements on non-centrally cleared derivatives to which non-financial entities that are not systemically important are a party, as such transactions pose little or no systemic risk. In principal I support that the requirements should not impose margin requirements on non-financial entities entering into non-centrally-cleared derivatives that are used for hedging or mitigating commercial risk, given that such transactions pose little or no systemic risk.[2]

Universal two-way margins

I fully support the concept of universal two-way margining. In principle this would meet the requirements of a well-designed margin system, as explicitly recognised by, among others, the Commodity Futures Trading Commission (CFTC):

> Well-designed margin systems protect both parties to a trade as well as the overall financial system. They serve both as a check on risk-taking that might exceed a party's financial capacity and as a resource that can limit losses when there is a failure.[3]

[1] Available at: www.bis.org/publ/bcbs226.pdf
[2] For completeness I would add that such derivatives should not be used to hedge or mitigate the risk of other derivative positions, unless those other positions themselves are held for the purpose of hedging or mitigating commercial risk.
[3] See commentary in CFTC Notice of proposed rulemaking: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 28 April 2011.

However, a well-designed margin system should ensure the safety and soundness of covered entities, and be appropriate for the risks associated with non-centrally-cleared derivatives. I would caution against the aggressive use of thresholds as a tool to manage the liquidity impact associated with margin requirements. Such thresholds are arbitrary, reduce market integrity and increase systemic risk.

Eligible collateral for margin

I agree that assets collected as collateral for initial and variation margin purposes should be highly liquid, and "be able to hold their value in a time of financial stress". Therefore I agree that cash and high quality government, corporate and covered bonds should be eligible collateral, but I would caution against allowing equities as eligible collateral. Although I accept that diversification of collateral brings certain risk advantages, equities are too volatile and subject to jump risk, which therefore makes them unsuitable as collateral. Collecting entities would not be assured that their value would be sufficient to meet obligations, particularly during a period of financial distress.

Physically-settled FX forwards and swaps

In answer to your specific question number 1, I support that physically-settled FX forwards and swaps should be exempted from initial margin requirements and variation margin required as a result of either supervisory guidance or national regulation. Such physically-settled contracts pose limited systemic risk as their primary purpose is to transfer ownership rather than price risk.

Yours faithfully

C.R. Barnard

Chris Barnard