THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

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March 15, 2013

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C/ Oquendo 12
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Regarding: Second Consultative Document: Margin requirements for non-centrally cleared swaps

The Financial Services Roundtable[1] (the "Roundtable") respectfully submits these comments with respect to the Second Consultative Document on margin requirements for non-centrally cleared swaps (the "Consultative Document"). We support the efforts of the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO") to achieve international harmonization of margin requirements, which we believe to be critical to preventing regulatory arbitrage and maintaining a fair competitive environment. At the same time, there are aspects of the margin proposals that we consider a cause for concern, especially if implemented on a global scale. For this reason, we are particularly supportive of a phase-in period for margin requirements, which will allow markets to adapt more gradually to these requirements and allow regulators to assess their impact and make appropriate adjustments, if needed.

[1] The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs

In this letter, we identify certain challenges to harmonization and certain concerns about proposed aspects of the margin rules. We appreciate the opportunity to comment.

1. *International harmonization will require consistent treatment of products and entities to avoid creating regulatory gaps and arbitrage opportunities.*

Establishing the parameters of what should be regulated as a "swap" has been a significant challenge for regulators in the United States. For example, derivatives can be embedded in other agreements, and certain non-derivative products, such as insurance, can strongly resemble swap agreements that cover credit defaults or catastrophic event risk. Any circumstance under which the scope of the regulations is different across jurisdictions because swaps have been differently defined will create challenges for market participants.

A critical area in this regard is the treatment of foreign exchange swaps and foreign exchange forwards. BCBS and IOSCO have specifically requested comments on the appropriate margin requirements for FX swaps and forwards. As a result of a determination by the U.S. Department of the Treasury, FX swaps and forwards have been excluded from the United States' central clearing and margin regime, although they are still subject to certain rules under the new regulatory regime, including reporting requirements and external business conduct rules for swap dealers. Neither initial margin nor variation margin will be required to be exchanged under U.S. law for FX swaps and forwards. Many commenters provided extensive feedback on the Treasury proposal to approve the exemption, and we believe the arguments put forth with respect to the different characteristics of this market and the ongoing efforts to address settlement risk support a corresponding determination outside the United States. A different conclusion by BCBS and IOSCO would prevent harmonized treatment of these FX products and lead to significant regulatory arbitrage.

In addition, harmonization will require consistent treatment of parties, including consistent treatment and definition of commercial end-users. To the extent that comparable entities are treated differently in different jurisdictions, regulatory compliance will be extremely difficult and market participants will find regulatory arbitrage opportunities. One particular area of concern for the Roundtable is the treatment of entities that are below regulatory thresholds under the U.S. framework because they transact in a *de minimis* amount of swaps or because they rely on the ability to enter into swaps in connection with the origination of loans. To the extent that local regulators have excluded such entities from regulation, that treatment should carry over into their transactions with entities in other jurisdictions.

In general, we are concerned that the rules applicable to various transactions may be inconsistent or unclear, and may leave market participants subject to conflicting rules with no clear basis for determining which set of rules controls. We support an approach, such as that outlined in the Consultative Document, which would allow the parties to comply with a single set of margin regulations when a transaction is otherwise subject to two different but comparable margin regimes.

With respect to the appropriate treatment of the foreign branches of banks, we note the proposal to treat such branches consistently with the treatment of the home institution. In terms of operations and risk management across the enterprise, we believe this may well be a necessary approach. At the same time, if such treatment leads to different margin requirements than those required of comparable institutions in the host jurisdiction, competitive disadvantages may arise either for entities formed in the host jurisdiction or for such branches. The Roundtable does not now take a position on a final approach, but notes that this is a very complex determination with the potential to lead to significant competitive disadvantages.

2. *We appreciate the steps BCBS and IOSCO have taken to mitigate the liquidity impact of initial margin requirements, such as permitting the use of a broader range of assets, but we continue to have significant concerns about such impacts.*

BCBS and IOSCO have acknowledged the liquidity impacts that mandatory exchange of initial margin would have for uncleared swaps, and we appreciate the steps taken in the Consultative Document to address those impacts. We believe that even with such steps, the effect of mandatory, universal two-way margin exchange will be to withdraw significant liquidity from the market. Moreover, the mandatory segregation of initial margin would exacerbate those problems. We support the ability of a party to require segregation of such margin, but do not believe it should be required unless requested by either party. We therefore believe that BCBS and IOSCO should proceed cautiously in regard to such requirements.

We similarly believe that broad bilateral netting should be permitted in establishing margin requirements. Allowing netting will reduce costs and mitigate liquidity impacts for a wide range of market participants.

In addition, we support the establishment of a permitted threshold for margin collection that would allow transaction participants to use their internal credit determinations to the extent the resulting exposures do not create systemic risk. That said, we believe the proposal to allocate such a threshold across affiliated legal entities on both sides of a relationship adds unnecessary complexity to the proposal, especially for affiliated entities that maintain separate operations and engage in separate credit analysis. In many circumstances, operational separateness may be protective of the overall organization. We believe that entities that make credit determinations separately from their affiliates should not have to change those practices to allow them to use the proposed threshold effectively.

3. *We support excluding non-financial and non-systemically important institutions from margin requirements*.

We believe that there are many end-users of derivatives who should not be subject to margin requirements. For example, many commercial end-users provide robust collateral for their swap obligations under their credit facilities, but would not be able to provide the proposed forms of margin or be able to support daily margin calls.

Securitization and other special purpose vehicles likewise provide significant collateral packages but are not structured to allow a daily exchange of margin. We believe exclusions from margin requirements are appropriate in such circumstances. Margin, in other words, should be required where necessary to protect against systemic risk, but should not be required where doing so would eliminate access to hedging for commercial and other end-user entities. In addition, to avoid regulatory arbitrage, we believe the categories of entities that are excluded should be consistent internationally.

4. *Margin calculations using internal models should be allowed when appropriate, with a standardized approach available as an alternative.*

We support the proposed conditions under which internal models would be permitted to be used for the calculation of initial margin, which would include approval by the applicable prudential regulator. We also agree that such models should account for risk on a portfolio basis. In addition, we support the availability of a standardized approach to margin when the use of internal models is unavailable or insufficiently transparent.

Although we understand the basis for the proposal to not allow "cherry-picking" of margin methodologies, we believe that such consistency should not be required across counterparties (or, in some cases, across product types even for the same counterparties). For instance, some counterparties may be uncomfortable relying on the margin determinations made by a counterparty under its internal, proprietary model, and thus may prefer the transparency of a standardized approach. Other counterparties may prefer to use (or may insist on using) internal models for comparable instruments. Accordingly, we do not believe it will be possible for market participants to use consistent methodologies in all circumstances.

5. *We support allowing a broad range of assets to be used for margin collection, subject to appropriate haircuts, to minimize liquidity impacts.*

One concern that has been expressed with respect to margin requirements has related to potential impacts on the stock of high-quality liquid assets that would be available to meet such requirements, especially given the requirements for the use of such assets for other purposes under the Basel III accords. We believe a broad range of assets, so long as they can be readily valued, should be permitted to be used as margin.

6. Margin should generally not be required for inter-affiliate transactions.

In some circumstances, prudential regulators limit inter-affiliate transactions and require the exchange of margin to protect the regulated entity from its unregulated affiliates. We understand the rationale for such requirements and support limits on inter-affiliate transactions in appropriate circumstances. Such requirements are generally part of a larger, long-standing regulatory approach to such transactions. Accordingly, to the extent inter-affiliate margin is required, we believe the approach suggested by BCBS and IOSCO to leave such determinations to the discretion of the local regulatory authority would be appropriate.

Where such restrictions on inter-affiliate transactions do not exist, we do not believe that mandatory exchange of margin between affiliates should be required. Affiliate transactions are entered into for a variety of reasons, including to allow a single entity to act as a single point of contact for third party transactions and to better manage documentation and netting. Many corporate groups that use such an approach also have consolidated cash management and risk management functions. We believe the administrative and operational burdens that would be caused by inter-affiliate margin exchange do not justify such a requirement in most instances.

7. *We support an appropriate phase-in period for initial margin requirements.*

Given our concerns about mandatory exchange of initial margin, we agree that a phase-in of the relevant requirements is appropriate. In particular, a phase-in period would allow regulators to assess the impact of these requirements and any amplifying effect they may have as a result of other regulatory changes, such as the Basel III accords. A phase-in period should be accompanied by appropriate impact studies and should be flexible enough to allow adjustment to the extent significant concerns are raised.

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Again, we appreciate the opportunity to comment. If you have any questions about these comments, please do not hesitate to call me or Richard Foster, the Roundtable's Senior Regulatory Counsel, at (202) 589-2424.

Sincerely,

Richard M. Whiting

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Financial Services Roundtable