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FEDERATION
BANCAIRE
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BCBS - IOSCO

SECOND CONSULTATIVE DOCUMENT

MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED DERIVATIVES

FBF'S RESPONSE

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, *i.e.* more than 500 commercial, cooperative and mutual banks. They employ 500,000 people in France and around the world, and serve 48 million customers.

The FBF welcomes the BCBS / IOSCO initiative to address the issues regarding margin requirements for non-centrally cleared derivatives on a global basis, in order to foster harmonization and coordination across jurisdictions. We appreciate the opportunity to respond to this Consultative Document.

- **We consider that the revised proposals continue to result in an excessive liquidity drain, and that the mandatory bilateral IM framework for non-cleared derivatives introduces more risks than it resolves;**

- **We believe that both the regulators and the industry need to have a clear view of the scope of clearable derivatives by CCPs first, which depends on the availability of clearing solutions, in order to properly calibrate and implement margining for un-cleared derivatives without posing huge liquidity and operational risks to the system;**

- **We underline the inaccuracy of the QIS results because of the change in the level of application of IM threshold and misleading figures of available unencumbered assets;**

- **We believe that all FX forwards and swaps should be exempted from margin requirements;**

- **We welcome the scope for allowing re-hypothecation to a certain extent but we think that this ability should be opened more widely to all market participants;**

- **We suggest that the phase-in period for IM begins in 2020 instead of 2015 given the technical and regulatory issues market participants will have to face in the coming years;**

- **We strongly recommend examining alternative approaches and options in order to limit the potential damage of proposed requirements, especially the possibility for each covered entity to post all its required initial margins (as calculated for its whole un-cleared derivatives portfolio, across all its counterparties, based on multilateral netting and on netting across all asset classes) to a single custodian/ fund;**

- **Finally, we ask a clarification as to whether the counterparties should collect IM either on a pre-trade basis or after the transaction. When specified that IM « should be collected at the outset of a transaction[1] », we do think that it refers to a post-trade requirement.**

Part A - General Comments

OTC derivatives are vital to the real economy. They allow economic actors to optimize their capital and to secure their investments. We share a common objective of making these markets more secure and efficient without unduly penalizing an efficient way to properly reallocate risk within the economy. We recognize and strongly support the need for systematic, bilateral exchange of variation margin ("**VM**") which is an important mitigant of systemic risk. However, we believe that the proposal of posting additional bilateral, segregated initial margins ("**IM**") would drain an excessive amount of liquidity outside of the real economy and would probably damage the OTC derivative market in a disproportionate way to a point where any transaction, even for end-users, will be uneconomical, leaving most end-users exposed to market and economic risk.

In this context, the FBF would like to recall its main concerns on the application of IM:

Current proposals will not remove systemic risk but shift it or increase it

The FBF favours the principle of appropriate margining for un-cleared derivatives in order to reduce systemic risk and to foster financial stability. At the same time, we believe that both the regulators and the industry need to have a clear view of the scope of clearable derivatives by CCPs first, in order to properly calibrate and implement margining for un-cleared derivatives without posing huge operational risks to the system. We stress that under

[1] See 3.10 of the Consultation.

current OTC derivatives markets reform, the scope of un-clearable derivatives is not stabilized yet and relies on the capability of CCPs to develop adequate solutions for clearing.

An objective of the margin rules is to incentivise central clearing. We remind that we are already incentivised through capital requirements to clear centrally, as the amounts of cleared transactions between dealers demonstrate. However, if margin rules are meant to provide a penal cost to un-cleared transactions, such a disincentive should at least be restricted to product types where market participants have the choice to clear. E.g. it does not make sense to incentivise clearing for cross currency swaps or FX options as long as there is no viable clearing solution available that market participants could use. .

Moreover, current proposals will shift or increase systemic risk instead of reducing it: (i) by requiring additional risk taking in certain types of assets increasing most probably exposures to sovereign risks, additional repos transactions to collect collateral while creating counterparty risk or additional credit risk on the third party entity receiving the collateral; (ii) by deterring careful analysis by covered entities of their counterparties financial soundness as it could be perceived as no longer relevant; the level of the IM should reflect the credit worthiness of each participant, (iii) credit rating triggers within derivatives contracts can create a dynamic of their own in illiquid markets, which can result in cliff effects and therefore increase systemic risk and should not be permitted.

We underline the inaccuracy of the QIS results and express strong reservations on current calibration that will drain excessive amount of liquidity

There are two main reasons for inaccuracy of the QIS results:

- The respondents took as a basic assumption that the €50mm IM threshold was to apply at each legal entity level and not at consolidated group level. At the moment where the market participants had to respond to the QIS, the "consolidated group level" criterion was not mentioned;
- The 8% figure representing what is supposed to be the "available unencumbered assets" (for an amount of either 8750G€ or 21250G€) is totally misunderstood as this amount is already used by banks mainly to comply with LCR regulation and thus not available at all.

Consequently, proposed measures would lead to increased numbers versus QIS figures. Where a €50mm threshold would reduce margin needs by approximately 50%, the application at consolidated group level would increase these needs again by 25%.

We also stress that, if the internal models are not validated by regulators, then the standardised method will lead to a cumulative impact of a very significantly higher magnitude (a ratio of 11 to 1 compared with internal models). Such a large impact bracket raises legitimate uncertainties and concerns on the capacity of the financial system to absorb the impact of the current proposals.

Appropriate calibration and justification of appropriate threshold requires carrying-out a new QIS, as current assessment underestimates costs and impact of the proposed measures.

Current proposals will severely reduce the use of non-clearable derivatives avoiding the possibility for clients to hedge their risks

The proposed requirements would damage the non-standard OTC derivatives market to a point where any transactions, even for end-users, will be uneconomical, leaving most end-users exposed to market and economic risk. Even if the client leg is exempted from margining, the hedge will not benefit from the same exemption and the cost of hedging will be passed on to the client.

The very existence of exemptions from margin requirements designed for non-systemically-important corporates and sovereigns shows recognition that OTC derivatives are economically vital. Therefore the cost of margin requirements should be mitigated for all end-users.

As of the implementation date the liquidity provided by dealers on interest rates (notably cross-currency swaps) and equity derivatives which are not currently clearable will be severely diminished. This will have significant implications that need to be carefully examined, in particular in terms of valuation and risk management, if the market liquidity is sharply constrained.

Transactions with covered bonds issuers and SPVs should be exempted from margin requirements.

Operational constraints related to the implementation of current proposals are underestimated

Given their vast impact on OTC derivatives users in a multitude of areas, as well as the vital need for cross border coordination and harmonization to ensure consistency and avoid regulatory arbitrage, implementation of IM will be very challenging. Market participants need time to develop models and systems that will need to be approved by the regulators to calculate IM in an internationally consistent way. We stress the huge operational complexity related to the implementation of the current BCBS-IOSCO proposals, even in the most advanced jurisdictions. The industry will need to agree on new structures for the posting of IM, new relevant documentation, risk metrics and dispute protocols, under adequate monitoring by regulators to secure international consistency. Calculation of thresholds on a group basis is operationally difficult, legally unworkable and puts firms with a subsidiary structure at a disadvantage.

This will happen in a context when market participants will already have to implement a large number of regulatory changes in the coming years due to European (CRD IV, EMIR, MiFID II…), national (structural reforms…) and foreign (DFA, new Fed regime for foreign banks, Asia…) reforms.

In this context, we suggest that IM is introduced only after a thorough review of the cumulative impact of Basel 3 rules and CCP requirements on global market liquidity, including an assessment to make sure that risks are not over-collateralized. In this way, 2020 seems a fare more prudent and realistic timeframe than 2015.

We strongly recommend examining alternative approach and options in order to limit the potential damage to the real economy due to liquidity drain

To limit the potential damage to the real economy due to liquidity drain, we strongly recommend examining the possibility of extending the netting across the various asset classes.

We also ask BCBS and IOSCO to consider alternative proposals that would more effectively achieve the shared objective of reducing systemic risk, without creating additional uncertainties raised by current proposals. In particular, we strongly recommend examining the possibility for each covered entity to post all IM (as calculated for its whole un-cleared derivatives portfolio, across all its counterparties and based on multilateral netting) to a single custodian/ fund. This alternative would offer adequate protection to the financial system from the default of the covered institution, while mitigating the liquidity drain and improving the workability of the requirements.

Part B - Answers to the Second Consultative Document

Q1. Given the particular characteristics of physically-settled FX forwards and swaps, should they be exempted from initial margin requirements with variation margin required as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments?

The FBF welcomes this exemption that has been requested by many market participants in the context of the first consultation.

(i) The aim of IM and VM is to mitigate counterparty credit risk. However, the main risks for FX forwards and swaps is settlement risk, which is addressed by the ever increasing use of Payment-Versus-Payment systems;

(i)

(ii) Counterparty credit risk and systemic risk is far lower for FX forwards and swaps than for any other derivatives;

(iii) the majority of the contracts is very short term;

(iv) given that there are no intermediate payments, market participants know the exact payment obligations to their counterparties through the life of the contract.

Hence we are of the opinion that the cost of imposing margin requirements on FX and forward swaps would be totally disproportionate to the benefit of the credit risk reduction that

it would bring. Moreover, a new source of risk would be generated instead, namely liquidity risk, as well as increased operational risk. Therefore, we do believe that FX forwards and swaps should be subject to neither IM nor VM.
It is also crucial that the treatment of FX forward and swaps is approached in a globally harmonized way, given the international character of FX business (according to the BIS, cross-border transactions represented 65% of trading activity in April 2010)[2].

Leaving the decision whether or not to apply VM up to the national regulator, would inevitably provide for regulatory arbitrage, lead to an un-level playing field, and as such, hamper efficient global trade and competition. The treatment of FX forwards and swaps should be aligned across jurisdictions and harmonized to a maximum extent.

Margining is not an appropriate tool to address FX risk, neither for short term nor for longer term contracts. Moreover, we do not see a meaningful difference in counterparty risk for shorter or longer term FX forwards and swaps.

Different treatment of different maturities (e.g. applying VM to contracts longer than 1 year) would simply shift the practice towards renewing short term contracts to avoid margining costs, which would create additional economic and commercial risk in the system.

We would like also to bring the attention to the necessity to have a clear and consistent definition of the FX derivatives to be exempted (FX forward, FX swap, CRS and others). In particular, we seek the Committee's confirmation that cross currency swaps are within the scope of exempted FX contracts.

Q2. Should re-hypothecation be allowed to finance/hedge customer positions if re-hypothecated customer assets are protected in a manner consistent with the key principle? Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; (ii) the pledgee treats re-hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.

A/ General Approach

The FBF would like to stress that as VM covers the current exposure due to the mark to market valuation of the derivative contract, it is crucial to transfer VM on full transfer or pledge (according to local applicable law) with full re-use/ re-hypothecation rights to the transferee/ beneficiary. Typically the general approach retained in the EU which consists in allowing re-use and re-hypothecation only with prior title transfer of assets posted as collateral and prior consent of clients should be preserved.

[2] BIS : Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 2010 – Final results (December 2010)

The FBF does not agree that there should be mandatory segregation or restrictions on the re-use right of IM (whether placed on a title transfer, or pledged, basis, according to local applicable law). As for VM, the general approach retained in the EU which consists in allowing re-use and re-hypothecation only with prior title transfer of assets posted as collateral and prior consent of clients should be preserved.

The liquidity squeeze which would arise would mean that it may simply not be possible for entities to hedge exposures at an economically feasible cost, once the cost of posting such collateral is taken into account. We also believe that the issue is not simply one of credit risk. It is more a question of understanding the risks arising in posting IM and the cost/risk benefit in doing so (if a party posts collateral, it should mean that the cost of the underlying transaction takes this into account).

If, however, the conclusion reached is that the restrictions on re-use or title transfer are required irrespective of the above considerations, we agree exceptions to such a prohibition are necessary. However, we would also stress that any such exceptions need to be stated in such a way that does not result in a non-level playing field globally. The questions posed appear to be written specifically from the context of US broker-dealers, and are less easy to apply in a wider framework. As mentioned previously it is not consistent with the general approach retained in the EU which consists in allowing re-use and re-hypothecation only with prior title transfer of assets posted as collateral and prior consent of clients.

In particular, it is necessary that any solution is properly supported by insolvency regimes. Whilst it would appear that the US regime would provide such support in relation to broker-dealers regulated by the CFTC, this is by no means consistent or indeed common in relation to entities which would take such collateral in other jurisdictions.

In any event, we would propose that the usage right should be looked at on a portfolio basis, such that the aggregate net proceeds of all re-hypothecations of client assets does not exceed the aggregate net resources used in the facilitation of all client transactions.

In addition, it should be made clear that a custodian should have re-use rights in relation to any collateral held with it, as long as the beneficiaries agree to such usage and have appropriate disclosure on these rights of re-use. To be consistent with the approach retained in the EU, prior title transfer should be another pre-requisite in this context.

B/ In order to address the re-hypothection issues, the following proposal should be considered:

In the light of our view that re-hypothecation should be allowed in a manner as to provide efficient protection to the IM payer, we propose that**:**

- Re-hypothecation should be permitted following substantial reforms to legal and insolvency regimes of all countries concerned;
- In the interests of improving security and reducing systemic risk, a regime of IMs on bilateral un-cleared derivative transactions must afford sufficient protection to IM payers.

Therefore, the possibility should be considered of payment of IM amounts to a systemically protected third party:

a) <u>Third Party Custodian / Trustee for IMs:</u>

The use of a systemically protected third party as receiver of all IMs should afford efficient protection to all IM payers; the third party would in effect fulfil the role of custodian and trustee for both IM payer and IM receiver, distributing to the receiver the IM in case of default by the payer, and returning to the payer the IM in case of default by the receiver.

The third party would not necessarily have any role to play in verification or control of amounts paid and received, merely in accounting for such amounts and holding them under specific legal terms for the benefit of payer or receiver in the event of default by on of the parties.

b) <u>Net Portfolio Basis vs. Asset Class:</u>

IM should be calculated on a net portfolio basis rather than by asset class. Calculation on net portfolio basis is essential to limit the liquidity impact and to better reflect and address the real risks.

Please refer to **Part C** bellow on further remarks to the Second Consultative Document on suggestions for IM calculations.

Q3. Are the proposed phase-in arrangements appropriate? Do they appropriately trade off the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements? Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?

We would suggest that VM are applied for all market participants as soon as the margin framework becomes effective, i.e. as of January 2015, as we consider this practice key for the mitigation of systemic risk in the un-cleared derivatives space. However, a degree of flexibility should be allowed for:

- set-up delays, including systems and documentation; and,
- VM exchange frequency and methodology (a weekly VM exchange frequency should in our view be considered for less important, in volume/risk terms, institutions).

On the other hand, we would strongly recommend to start the phase-in of IM at a later date, for the following reasons:

(i) There will not be a clear view of the scope of application of IM until all possible clearing solutions have been developed by CCPs;

(ii) IM solutions need to be properly designed in order to allow banks to continue to finance the economy and to effectively mitigate risk in the system;

(iii) IM solutions need to be put in place in a perfectly aligned manner across jurisdictions given the cross-border character of the derivatives market (same scope, calendar, collateral rules, haircut rules etc.);

(iv) Market participants need to develop models and systems that will need to be approved by the regulator to calculate IM;

(v) Different regulatory requirements will all be put in place together in the very near future that will have collateral immobilized in the system (LCR, collateral requirements for centrally cleared derivatives), the impact of which is unclear at this moment;

(vi) In the coming years market participants will have to face a huge challenge in terms of regulatory burden as they will have to implement a large number of regulatory change due to European (CRD IV, EMIR, MiFID II, FTT…), national (structural reforms…) and foreign (Dodd-Frank Act, new Fed regime for foreign banks, Asia…) reforms.

Furthermore, the FBF would like to stress on the following issues:

- The implementation of margin requirements should not depend on the size of the counterparty, otherwise it would lead to unintended side effects: This would create an un-level playing field leading to risks being transferred to smaller and less equipped players and as a consequence not reducing systemic risk;

- If BCBS-IOSCO want large players to exchange IM on an appropriate basis limiting systemic risk, they need to give them time to think through and implement the new set-up;

- We consider that the notional value of un-cleared derivatives is not the most appropriate indicator to identify a group which has exceeded a certain level of risk on uncleared derivatives positions. Other indicators could be used with more efficiency and to better identify the largest positions holders;

- We think that a dedicated regime should be determined in the context of the phase-in for products that cannot be centrally cleared because of their specificities (cross-currency swaps, some interest rates or equity derivatives).

We then stress the huge operational complexity related to the implementation of the current BCBS-IOSCO proposals, even in the most advanced jurisdictions. The industry will need to agree on new structures for the posting of IM, new relevant documentation, risk metrics and dispute protocols, under adequate monitoring by regulators to secure international consistency.

To achieve this by 2015 does not seem realistic.

In addition, the regulation with this proposed phase-in will hit the major part of the activity as it is applied to the largest counterparties. It will also create a shift from large entities to smaller ones, not only creating unfair competition but also destabilising the market potentially creating additional risks as smaller players are less equipped to manage their risks.

Consequently, the un-precendented implementation of IM by January 2015 seems overly ambitious and would have a detrimental effect on liquidity. Therefore we suggest that IM is introduced only after a thorough review of the cumulative impact of Basel 3 rules and CCP requirements on global market liquidity. Next to that, also capital holdings need to be reassessed to make sure that risks are not over-collateralized.

In this way, 2020 seems a far more prudent and realistic timeframe than 2015 to implement IM requirements.

Nevertheless, we believe that VM requirements could be applicable as of 2015.

Q4. The BCBS and IOSCO seek comment on the accuracy and applicability of the QIS results discussed above.

We underline the complete inaccuracy of the QIS results for the two main reasons:

1. **Threshold calibration**:

The respondents took as a basic assumption that the €50mm IM threshold was to apply considering each legal entity and not at consolidated group level. At the moment where the market participants had to respond to the QIS, the “consolidated group level” criterion was not mentioned.

The proposal to aggregate exposure at group level for the €50mm IM threshold computation will lead to increased numbers versus QIS figures and will generate increased operational risks. Where a €50mm threshold would reduce margin needs by approximately 50%, the application at consolidated group level would increase these needs again by 25%.

We have strong reservations on the approach taken to set the threshold of €50 million for reasons of coherence. The calculation of IM and threshold should be consistent: either both are calibrated and calculated on a netting set basis, or both are calculated on a group basis.

We believe that the threshold should be calibrated on a netting set basis, based on an adequate QIS.

2. **Unencumbered assets**:

The 8% figure representing what is supposed to be the "available unencumbered assets" (for an amount of either 8750G€ or 21250G€) is totally misleading as this amount is already used by banks mainly to comply with LCR regulation and thus not available at all.

The numbers mentioned here must be considered with caution:

(i) The accumulation of the different regulatory initiatives (LCR, Clearing obligation, margins for un-cleared derivatives) will change collateral demand significantly and may result in a shortage of high quality collateral. The 8% figure representing the ratio of increased IM needs to the available unencumbered margin eligible assets is misleading as available collateral is already used by banks mainly to comply with LCR regulation. Thus this collateral is "encumbered" in a way in order to comply with other regulations and therefore not available;

(ii) The IMF Working Paper '"*The Changing Collateral Space*"[3] states that "*although BIS indicates about $1.8 trillion of collateral dedicated to this market, this collateral is fungible and includes a re-use factor of about 2.5 to 3, dedicated collateral may be only $600-$700 billion.*" Hence the potentially available pool of collateral is not as big as expected because of the re-use (or velocity, see below) and increased collateral needs are disproportionate knowing that IM are supposed to be non-re-hypothecable.

The obligation to post and hold non re-hypothecated IM on a gross basis into segregated accounts will cancel collateral velocity (re-use) and by consequence will reduce significantly available supply of collateral and financial markets efficiency.

In addition, we do not agree with the approach taken regarding standardized haircuts for assets in which the currency of the derivative obligation differs from that of the collateral asset. An 8% haircut of market value seems overly conservative, does not reflect normal market conditions and therefore is quite punitive in terms of liquidity impact. We would suggest applying a lower haircut for USD, GBP and JPY which would better reflect market practice.

If the collateral is Cash, and collateralisation (VM particularly) happens daily, then the risk of receiving cash in a different currency is an FX risk on the 1-day VARIATION of VM, as the collateral amount (principal amount of VM, not its daily variation) could be swapped daily or converted daily into the currency of the underlying swaps. So applying an 8% haircut to ANY

[3] WP/13/25 IMF Working Paper : The changing Collateral Space - Manmohan Singh (January 2013)

currency is just overkill for a risk which is of a 2nd order: variation of FX on the variation of IM, over a 1-day horizon.

We stress that current estimations provide a much too wide range of numbers, depending on the scope of model approvals. According to the QIS, if the internal models are not validated by regulators, then the standardised method will lead to a cumulative impact of a very significantly higher magnitude (a ratio of 11 to 1 compared with internal models.

For these reasons, a new assessment is absolutely necessary to calibrate adequately initial margins.

Part C. Further Remarks to the Second Consultative Document

1. Scope of coverage – scope of applicability

In addition to non-systemic non-financial entities, margin requirements should not apply to transactions for the following counterparties:

(i) Regulated retail funds (e.g. UCITS in Europe);

(ii) Intra-group transactions;

(iii) Derivatives with SPVs and covered bonds.

SPVs for the purpose of repacking assets should be exempt from the margining rules. Typically, but not exclusively the SPV route is chosen for creating covered bonds and ABS, which are very important refinancing tools for banks and corporates. Derivatives in this context are typically being used to smooth and match the cash-flows of the assets vs the liability of the SPV. Usually risk is mitigated by the structure of these transactions and additional mitigation by margin would be inefficient. The swap provider typically ranks super-senior or pari-passu with the assets in the SPV and as such has already a safety net. If the SPV is rated, over-collateralisation structures to protect the SPV/note-holder are already in place today.

2. Clarification as to whether the counterparties should collect IM either on a pre-trade basis or after the transaction

To develop models and systems, it is of mere importance that market participants can understand when they have to collect IM. This would clarify the circumstances under which IM re-calculation for an existing portfolio of transactions has to be performed even if no changes have been made to the trade population. Further, it would clarify when a change in calculated IM for the portfolio would require the counterparties to actually collect additional IM (or pay back excess IM).

When specified that IM « should be collected at the outset of a transaction[4] », we do think that it refers to a post-trade requirement.

3. Baseline minimum amounts and methodologies for variation margin and initial margin

The proposal of posting two-way IM for any institution is disproportionate to the risk which is intended to be mitigated. It will drain a most probably huge amount of liquidity outside of the real economy, subordinate other unsecured liquidity providers and create additional credit, market and operational risks for the posting party.
Against this backdrop, IM should be computed on a portfolio basis and the right approach to take is the computation across asset classes - not segregated per type of asset class.

4. Application to Different Counterparty Types:

We believe that a regime for IMs on un-cleared bilateral derivatives must take into account the nature of the bilateral counterparties. Specifically, two broad parameters should be taken into account:

- **Regulation**, i.e. regulated entities (e.g. banks) vs unregulated entities (e.g. hedge funds)
- **Size**: the size in risk terms of a counterparty's bilateral derivative portfolio relative to its tangible net worth (or NAV …).

We believe that these differences in type or size should be reflected in the application of the approach for IMs via different threshold levels for IMs.

We would suggest not applying the same thresholds for all counterparties but introducing a differentiated approach based on regulatory status of each institution. This could be along the following lines:

Threshold in Mios	**Regulated Entity**	**Non-regulated Entity**
	100	**50**

We consider that this suggested approach would fit better the sorts of different entities in the derivatives markets. At the same time this approach should generate a lower liquidity impact than common 50 million EUR thresholds, suggested in the second consultative document.

It should be recalled that appropriate calibration of these thresholds would require a new QIS.

[4] See 3.10 of the Consultation.

5. Application and Thresholds by Counterparty, not "Group":

Application of thresholds on a consolidated group level is impractical for many larger institutions and not coherent:

- bilateral documents covering derivatives are signed by legal entity and not by consolidated group, and legal recourse in the case of default of a counterparty, absent corporate guarantees, is to the individual legal entity and not to the "group";
- small entities being part of a large consolidated group will not have significant derivative portfolios, nor represent the same systemic risk as the largest (corporate and investment bank) entities of same group;
- a consolidated group threshold could also lead to problems (and secondary risks) in allocation thereof among various group entities.

In addition, while we understand that computing thresholds at Group level aims at avoiding IM optimisation, we would like to underline that when a group enters into transaction through various entities, it reduces its netting effect, increasing its counterparty risk and therefore its capital requirement. Therefore, if IM are appropriately calibrated, for entities subject to capital requirement, this should not lead to any regulatory arbitrage.

We believe that the threshold should be applied by legal entity instead of "consolidated group" in order to better suit market and legal contractual realities.

6. Treatment of the provided initial margin

(i) Defining which type of entity that can hold the posted IM is key: concentration at private entities could well increase overall systemic risk. Therefore we suggest that Central Banks or Resolution Authorities play this role which would also have the benefit of facilitating liquidity monitoring;

(ii) If IM were to be posted at a Central Bank or Resolution Authority, it would make sense to do so netted across ALL positions, instead of being constructed CSA by CSA;

(iii) In this way, a single Liquidity Buffer would be created, held centrally, calculated globally across all counterparties of an institution in scope.