ING response to IOSCO second consultative document on 'Margin requirements for non-centrally cleared derivatives'

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About ING

ING is a global financial institution of Dutch origin, offering banking, investments, a variety of life insurance, non-life insurance and retirement services to meet the needs of a broad customer base. Going forward, we will concentrate on our position as a predominantly European bank, while creating an optimal base for an independent future for our insurance and investment management operations.

With more than 84,000 employees, we serve over 61 million private, corporate and institutional customers in over 40 countries in Europe, North America and Latin America, Asia and Australia.

We draw on our experience and expertise, our commitment to excellent service and our global scale to meet the needs of a broad customer base, comprising individuals, families, small businesses, large corporations, institutions and governments.

Introduction

ING welcomes the opportunity given by IOSCO to provide feedback on the near final proposal on margin requirements for non-centrally cleared derivatives. In the answers provided by ING to the questions below, ING opines that the proposed phase-in arrangements should not commence before 2017. As several key elements of the original proposal of the Working Group have changed, ING advises to perform a new QIS based on the near-final proposal after taking into account the comments received in the current consultation round.

Questions

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?

ING Bank is of the opinion the physically settled FX forwards and FX swaps should be exempted from initial margin requirements regardless of maturity.

Firstly, the impact study shows that FX forwards and FX swaps notionals will represent 44% (for ING 41%) of the remaining uncleared OTC Derivatives business after regulatory clearing requirements were to be implemented. The disproportionate importance of the FX Forwards and FX Swaps business in the total remaining uncleared OTC Derivatives business is largely driven by the fact that these instruments can hardly be cleared (according to the QIS results for 13%). Consequently, promotion of central clearing (one of the two objectives of the near-final proposal) can be achieved to a limited extent only.

Secondly, the overwhelming liquidity impact that the original proposal would result in would be reduced substantially when these products are excluded from the scope (in case of ING Bank by 61% of the initial margin requirements after the clearing requirements are implemented)

Thirdly, FX Swaps and FX Forwards are crucial in managing the liquidity position of the bank. Penalizing this instrument by imposing extra constraints on liquidity seems counter-intuitive.

Fourthly, the supervisory guidance for managing risks associated with the settlement of foreign exchange transactions that was published in February 2013 provides a comprehensive framework for managing risks associated with FX Forwards and FX Swaps. ING strongly supports these guidelines and is of the opinion they should not need to be extended with initial margin requirements.

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.

ING believes re-hypothecation should be allowed in any case that is consistent with the key principle as it will offer protection while not trapping the liquidity associated with initial margin requirements.

Re-hypothecation of received Initial Margin should be allowed under the specific conditions that the party to which the assets are re-hypothecated treats this collateral as customer assets and the applicable insolvency regime allows customer-first priority claim over the pledged collateral.

Close alignment between regulatory industry bodies and the industry is required to safeguard that the conditions under (ii) and (iii) in particular are met

The proposal speaks in the context of the re-hypothecation of received Initial Margin collateral of pledged collateral and pledgee / pledgor. ING Bank believes that the pledge construction is the correct mechanism in this instance.

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?

ING Bank is of the opinion that rolling out the implementation schedule should not commence before 2017.

Based upon a study executed by a major European regulator, it is expected that there may be a shortage in high grade collateral taking place in 2016. Hence, ING Bank believes that the liquidity costs are not appropriately reflected in the proposal to start rolling out the implementation schedule from 2015 onwards. Furthermore, the operational costs related to putting into place initial margin models for all distinct asset classes, receiving regulatory approval for these models across jurisdictions and integrating these models into a real-time margining infrastructure are a point of concern.

ING Bank agrees with the proposal to phase in the requirements relative to the size of the applicable notional size of the involved institutions and applauds the Working Group for not allowing asymmetric initial margin posting obligations between two institutions.

ING Bank believes that variation margin requirements should follow the same implementation schedule as initial margin requirements. An extreme effort will be required to sign CSAs with covered entities that ING Bank currently does not have CSA with. Whereas only 12% of the notional outstanding of ING Bank's uncleared OTC Derivatives do not fall under a CSA, the relevant trades are outstanding with a large set of smaller counterparties. The exact number of CSAs that need to be signed depends on which entities will be classified as non-systemic, non-financial counterparties according the national regulation.

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

The results of the QIS which were based on the initial proposal by the Working Group are generally in line with ING Bank's contribution to the QIS and are largely in line with ING Bank's expectations.

However, several key elements of the proposal have changed (a new standardized initial margin method, a change in covered entities, uncertainty about the inclusion of FX Forwards and swaps, more certainty about the application of Thresholds, etc).

Specifically, it should be noted that in the 2012 QIS the Thresholds were applied across all legal entity combinations between groups. In the near-final proposal, the (EUR 50 mln) Thresholds represent the maximum Thresholds that can be applied between two groups and their subsidiaries. This substantially impacts the liquidity consequences as suggested by the QIS.

Thus, ING Bank advises to perform a new QIS based on the near-final proposal after taking into account the comments received in the current consultation round.

On a general note, ING Bank is of the opinion that possible adverse movements in the valuation of OTC Derivatives in case of a default should be absorbed by capital that banks are required to hold instead of by the mandatory exchange of initial margin. This method allows more effectively for taking account the specific credit assessment of relevant counterparties.

If Initial Margin is applied, ING Bank is of the opinion that full netting and diversification benefits across asset classes should be allowed in line with economic reality.

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