STATE STREET.

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Via email: baselcommittee@bis.org and wgmr@iosco.org

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Secretariat of International Organization of Securities Commissions (IOSCO)
Oquendo 12
28006 Madrid, Spain

Re: Second Consultation - Proposal on Margin Requirements for Non-Centrally Cleared Derivatives

Dear Sir/Madam:

State Street Corporation appreciates the opportunity to provide comments on the second consultative paper (the "Consultative Paper") on margin requirements for non-centrally cleared derivatives published by the joint Working Group on Margining Requirements ("WGMR") of the Basel Committee on Banking Supervision and the International Organization of Securities Commissions.[1]

Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $24.37 trillion in assets under custody and administration and $2.09 trillion in assets under management at December 31, 2012, State Street operates in 29 countries and more than 100 geographic markets worldwide.

As we noted in our September 28, 2012 comments on the first consultative paper, State Street strongly supports the efforts of regulators to reach a global agreement in relation to margin for non-centrally cleared swaps, and agrees with the WGMR that appropriate margining of such swaps is important to addressing systemic and idiosyncratic risks associated with these activities. At the same time, we appreciate the need to strike an appropriate balance between reducing systemic risk without causing a de-stabilizing drain on liquidity and appreciate the

[1] Margin Requirements for Non-Centrally Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, February 2013, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD403.pdf

WGMR's efforts to balance these benefits of margin requirements with their potentially negative impacts.

We also urge the WGMR to ensure that the final agreement on margining for non-centrally cleared swaps create appropriate incentives for counterparties to move from an OTC to a centrally-cleared mandate for swaps that fall within the scope of the G20 commitment to increased central clearing for standardized swaps.

Our comments today focus on two key unresolved issues presented in the Consultative Paper.

First, we continue to strongly oppose regulatory imposition of either variation or initial margin on foreign exchange transactions. Such transactions are demonstrably different than the interest rate, CDS and other credit-intensive swaps that contributed to the recent financial crisis, and which are the main focus of global regulatory efforts. Imposing mandatory initial or variation margin on such FX transactions will add little beyond current, successful efforts to reduce systemic risk, and will have significant negative impacts on global investment and trade.

Second, while we agree with the WGMR's high priority established in the Consultative Paper on protection of posted margin, we continue to disagree with suggestions in the Consultative Paper that access to assets held in third-party custodial accounts could be unduly limited in certain circumstances. As we described in our September, 2012 comment letter, current custodial agreements and market practice ensure full and unfettered access to such assets for posters of collateral, and third-party custody remains the most robust form of collateral protection.

In addition, we would further encourage the WGMR to promote best market practice by clarifying that third party custody of initial margin should be available to all market participants, regardless of whether such initial margin is posted voluntarily or under a regulatory mandate, and regardless of the business model of the swap dealer engaged in the transaction.

Scope of Coverage – Foreign Exchange Swaps and Forwards

State Street strongly opposes mandatory margin for foreign exchange forwards and swaps. Such transactions are distinctly different than other types of swaps, involving the straightforward exchange of currencies on fixed and pre-determined terms in a highly transparent and liquid global marketplace. The vast majority of foreign exchange forwards and swaps are short-dated[2], resulting in minimal credit risk between counterparties. While settlement risk is an important consideration with foreign exchange swaps and forwards, it has largely been addressed, at the urging of regulators, through creation of the CLS Bank International. As a result, foreign exchange forwards and swaps do not significantly contribute to the interconnectedness or systemic risk concerns the margin rules are intended to address.

Applying mandatory margin rules to foreign exchange forwards and swaps could, however, have significant negative effects on the global economy. Foreign exchange forwards and swaps are a critical source of funding and liquidity in the global marketplace, and foreign exchange

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[2] According to the Treasury determination [77 FR 69697 (2012-11-20)], 98% of foreign exchange forwards and swaps mature in less than one year.

markets are critical to the global payments system, supporting all cross-border trade and investment. Applying unnecessary margin rules to foreign exchange forwards and swaps would undermine the ability of foreign exchange markets to support this critical global activity.

In addition, given the size of global foreign exchange markets and the volume of foreign exchange forwards and swaps, applying unnecessary margin rules and the associated segregation regimes would greatly increase the demand for high quality collateral, exacerbating the liquidity impacts the WGMR is seeking to minimize.

Finally, as the WGMR is aware, the U.S. Department of Treasury has issued a determination pursuant to its authority under the U.S. Dodd-Frank Act that places foreign exchange swaps and forwards outside of the definition of swaps for purposes of most U.S. swaps rules.[3] This determination was expressly authorized by the U.S. Congress as part of the Dodd-Frank Act, and was based on a lengthy and thorough consultative process by the Department of the Treasury. This consultative process focused on both the nature of these FX transactions, and the existing regulatory oversight of U.S. FX dealers, nearly all of whom are banks fully subject to prudential regulation.

We believe that this determination is consistent with an exclusion of foreign exchange swaps and forwards from the global agreement on margin requirements for non-centrally-cleared derivatives, and encourage the WGMR to adopt this position.

Protection of Provided Margin

While we acknowledge that other forms of protection can be workable, third-party custody accounts continue to provide the most robust option for protection of posted margin. Securities held as margin with custodians are held in segregated, bankruptcy-remote accounts that are not on the balance sheet of the custodial bank. In the case of cash margin, bank custodians typically offer an array of cash services, which include on-balance sheet deposits, but also include a wide range of off-balance sheet investment vehicles. Margin posted to such accounts is readily available to the swap counterparties under contractual arrangements that provide the custodian specific criteria for the margin's release or return.

As we described in our September, 2012 comment letter, concerns that such accounts may have, in some instances, resulted in limited access to assets held in such accounts have been addressed through improved market practices and contractual arrangements. The use of third-party custody accounts is increasingly demanded by market participants, and the option to use such accounts is mandated by the U.S. Dodd-Frank Act for initial margin for non-centrally cleared swaps.[4] In addition, the U.S. CFTC recently permitted the use of third-party custodial arrangements in connection to margin posted for cleared swaps as well,[5] recognizing that many market participants value such protections both for themselves and in strengthening confidence in markets more generally.

[3] As a result of the determination, only the U.S. swap reporting and business conduct rules will apply to dealers in foreign exchange forwards and swaps.
[4] Dodd–Frank Wall Street Reform and Consumer Protection Act, Section 724(c)
[5] 77 FR 6343 (2012-2-7)

As mentioned in Footnote 16 of the Consultative Paper, however, there are instances where conflicting regulatory mandates may result in punitive treatment of counterparties availing themselves of the protection offered by third party custody. Specifically, the WGMR references U.S. SEC rules which impose a capital penalty on broker-dealers holding posted margin for non-centrally cleared swaps in third-party custody accounts. We view this conflict as a correctable flaw in the SEC's net capital rule, however, and not a weakness in the WGMR's commitment to protection of margin posted in connection with non-centrally cleared swaps. We urge the WGMR to encourage national regulators to ensure that capital or other rules do not reduce the availability of third-party custody of margin, or otherwise reduce the protections available to posters of margin in connection with non-centrally cleared swaps.

In addition, we note that the approach proposed in the Consultative Paper would limit mandatory initial margin to covered entities with over 8 billion euros in gross notional outstanding swaps, which we understand is intended to focus regulatory mandates on dealers and other highly active swaps market participants. In addition, the WGMR proposes a 50 million euro threshold for the exchange of margin, which will further limit initial margin posted under a regulatory mandate. We do not oppose this proposed approach, and appreciate the WGMR's interest in focusing these rules on activities presenting significant systemic risk, and its interest in minimizing the liquidity impacts of the proposed margin requirements.

We believe, however, that significant levels of initial margin will continue to be posted on a voluntary basis, based on market practice. Such posted margin should be provided the same level of protection as collateral posted under regulatory mandates. Third-party custody, for example, should be an option for all counterparties, whether covered by the WGMR's global agreement or not. In the U.S., all counterparties to uncleared swaps must be offered the option of third-party custody. We urge the WGMR to adopt a similar approach in its final agreement on margin for non-centrally cleared swaps, and require that swap dealers provide the option of third- party custody and segregation for initial margin posted in connection with non-centrally cleared swaps.

Once again, we appreciate the opportunity to comment on the Consultative Paper. We strongly support the work of the WGMR, and believe a global agreement on margining practices for non-centrally cleared swaps is critical to the emerging new market structure for swaps. Please feel free to contact me with any questions.

Sincerely,

Stefan M. Gavell