

From: Alex McDonald [mailto:amcdonald@wmba.org.uk]
Sent: Friday, March 22, 2013 8:04 PM
To: baselcommittee@bis.org; Consultation Reports
Cc: Michelle Caulfield; Alex McDonald
Subject: WMBA&LEBA_response_-_BCBS and IOSCO consultation on margin requirements

Dear Basel Committee and WGMR Secretariat,

Please find our reply attached.

WMBA apologies for the late delivery and brevity of this reply, but nevertheless welcomes the opportunity to respond to the issues raised in the second consultative document on margin requirements for non-centrally cleared derivatives.

Key messages:

- WMBA are concerned that the level of initial margin proposed is set at such a high level that it will have a disproportionate effect on the balance between reducing counterparty risk on the one hand, which we support, and harming liquidity in the financial markets. We are concerned that this high level of margin would mean that market makers will withdraw from the derivative markets, with consequences for the general economy in that end-users of the market will find it harder to hedge their currency or inflation rate risks.
- Furthermore, we consider that the proposed restrictions around the treatment of collateral that is posted as initial margin simply may result in a lack of sufficient eligible collateral, exacerbated by the requirement to exchange initial margin on a gross basis. This will add to the potential negative liquidity impact.
- Physically settled products, such as FX swaps and forwards, should be exempt from these margin requirements, as this set of initiatives are designed to address issues around settlements and payments, not market or credit risk. We believe that commodity derivatives that are physically settled should be subject to different treatment within their asset class, and also exempt from the requirements, given the risk to the real economy should the same high margin requirements serve to reduce liquidity in this space, impacting on their use by non-financial counterparties.

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (*jointly referred to in this document as the 'WMBA'*) are the European industry associations for the wholesale intermediation of Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity and Limited Licence firms (as defined by the UK Financial Services Authority) that act solely as intermediaries in wholesale financial markets.

WMBA members are active in arranging liquidity and executing the majority of trades across all the relevant markets, including the physically settled markets.

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The Wholesale Markets Brokers' Association and London Energy Brokers' Association

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Introduction

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Response

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?

Margin requirements should not apply to physically-settled FX swaps and forwards. Indeed, we believe that all physically-settled products, including commodities and cross-currency swaps, should be exempt from these requirements. Imposing different margin requirements on physically-settled FX forwards and swaps with different maturities may simply lead to arbitrage in this space.

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 pledge treats re- hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.

These requirements are too severe and will have a unnecessary strain on collateral, in addition to increasing operational risk and dissuading hedging. As it is important for our members to keep this proposal consistent with that proposed by the SEC, a counterparty to an OTC derivatives (swap) dealer should be able to choose between waiving segregation (i.e. permit re-hypothecation), omnibus segregation on the books of the dealer, or individual segregation at a third party custodian.

Q3: Are the proposed phase-in arrangements appropriate?

We are supportive of the concept of phase-in arrangements, but we would recommend that the phase-in dates should begin only once all G7 regulators have margin requirements for non-centrally cleared OTC derivatives in place, rather than a fixed date of 2015. The phase-in period should also coincide with other Basel, and therefore CRDIV, capital charge roll-outs.

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

Given our comments above, we should like to see a further QIS undertaken to accommodate all the responses to this consultation. In particular, in relation to question 2, the amount of eligible collateral that would actually be available for use should be examined. In relation to question 1, the proposed dynamics of the initial margin, such as the threshold amounts, should be examined.

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