September 28, 2012

 Basel Committee on Banking Supervision
 Bank for International Settlements
 Centralbahnplatz 2
 CH-4002 Basel
 Switzerland

 Mr. David A. Stawick
 Secretary
 Commodity Futures Trading Commission
 Three Lafayette Centre
 1155 21st Street, NW
 Washington, DC 20581

 Mr. Robert deV. Frierson
 Secretary
 Board of Governors of the Federal Reserve System
 20th Street and Constitution Avenue, NW
 Washington, DC 20551

 Mr. Robert E. Feldman
 Executive Secretary
 Attention: Comments
 Federal Deposit Insurance Corporation
 550 17th Street, NW
 Washington, DC 20429

 International Organization of Securities Commissions
 C/ Oquendo 12
 28006 Madrid
 Spain

 Mr. Gary K. Van Meter
 Director
 Office of Regulatory Policy
 Farm Credit Administration
 1501 Farm Credit Drive
 McLean, VA 22102–5090

 Mr. Alfred M. Pollard
 General Counsel
 Attention: Comments/RIN 2590–AA45
 Federal Housing Finance Agency
 Eighth Floor, 400 Seventh Street, SW
 Washington, DC 20024
Re: BCBS/IOSCO: Comment Letter on the Consultative Document for the Margin Requirements for Non-Centrally-Cleared Derivatives

CFTC: Comment Letter on the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038–AC97), Comment Period Reopened (Release: PR6297–12)


Board: Margin and Capital Requirements for Covered Swap Entities (RIN 7100 AD74); Reopening of Comment Period

FDIC: Margin and Capital Requirements for Covered Swap Entities (RIN 3064–AD79); Reopening of Comment Period

FCA: Margin and Capital Requirements for Covered Swap Entities (RIN 3052–AC69); Reopening of Comment Period

FHFA: Margin and Capital Requirements for Covered Swap Entities (RIN 2590–AA45); Reopening of Comment Period

To Whom It May Concern:

The Asset Management Group (the “AMG”)\(^1\) of the Securities Industry and Financial Markets Association (“SIFMA”) appreciates the opportunity to provide the Commodity Futures Trading Commission (the “Commission”), the Basel Commission on Banking Supervision (the “Basel Commission”) and the Board of the International Organization of Securities Commissions (“IOSCO”) (together with the Basel Commission, “BCBS/IOSCO”) and the U.S. prudential regulators (the “Prudential Regulators”) with our views on their recent releases regarding margin requirements for derivatives. Specifically, we appreciate the opportunity to comment on BCBS/IOSCO’s recently released consultative paper on margin requirements for non-centrally cleared derivatives (the “Consultative Paper”)\(^2\) and, in light of the Consultative Paper, to comment again on the CFTC’s and the Prudential Regulators’ proposed rules regarding uncleared swap margin requirements (the “CFTC Proposal” and the “Prudential Regulator Proposal”\(^3\))

---

\(^1\) The AMG’s members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions for hedging and risk management purposes that will be classified as “security-based swaps” and “swaps” under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

together, the “U.S. Proposals”). The AMG previously commented on the U.S. Proposals in a letter submitted July 11, 2011.

Given the international nature of the swaps market, we believe that coordination among regulators, both within the United States and internationally, is vital to the successful implementation of new swaps regulatory regimes. This is particularly the case for margin requirements, both because of the economic importance of margin payments and the fact that regulated entities may be subject to multiple margin regimes in multiple jurisdictions. Any true conflicts between the margin regulations of various regimes will result in a failure to satisfy at least one regime’s requirements. We therefore appreciate the U.S. Regulators’ willingness to reopen the comment periods on the U.S. Proposals in light of the new information about margin requirements provided in the Consultative Paper.

Because this letter arises in response to the recently published Consultative Paper, it is organized by the Paper’s seven key principles. In each section, we begin with a summary of the Consultative Paper position, the Commission’s position and the Prudential Regulators’ position on a specific issue, followed by our suggested approach on that issue and explanatory text.

For ease of reading, we provide a Table of Contents summarizing our views:

Preliminary Timing Concerns .................................................................6

A. When phasing in uncleared swap margin requirements, regulators should keep in mind operational, business and logistical issues. ................. 6

1. Uncleared margin rules should only become effective once all models submitted within the first 180 days after rule publication have been reviewed. ......................................................... 7

2. Uncleared margin rules should only become effective once all operational and documentation requirements for the uncleared margin requirements can be met. ......................................................... 7

---


3. Margin rules should only become effective for a particular swap after clearing is required for that swap, which will be a function of both the type of swap and the type of market participant. ............................ 7

B. Pre-effective swaps should only be used in margin calculations if both counterparties agree to do so......................................................................................................... 8

I. Scope of Coverage – Instruments Subject to the Requirements.......................... 8

A. “Foreign exchange swaps” and “foreign exchange forwards” should not be subject to margin requirements. ............................................................ 8

II. Scope of Coverage – Scope of Applicability ........................................................ 10

A. Margin requirements should be bilateral, unless the end user party elects not to require such margin from its counterparty. ................................. 10

B. Variation margin should be collected daily. .................................................... 11

C. Each party to a swap should be provided a sufficient period of time after execution of the swap to collect margin from its counterparty. .......... 11

D. Regulators should divide financial entities into five categories, to which different thresholds apply (in decreasing order): (i) regulated low-systemic risk entities, (ii) prudentially-regulated entities, (iii) low-risk financial entities, (iv) other entities (other than key market participants) and (v) key market participants................................................ 13

1. The first category should be regulated low-systemic risk entities, defined as entities that are subject to any regulation that establishes capital or funding requirements or restricts the use of leverage. Such entities should not be required to post initial margin, or in the alternative, should have very high thresholds. ................................. 14

2. The second category should be “prudentially-regulated entities.” ............... 17

3. The third category should be “low-risk financial end users” (that are not regulated low-systemic risk entities and are not prudentially-regulated entities), defined as entities that do not have “significant swaps exposure” and are minimally leveraged relative to net assets....... 17

4. The fourth category should be all other market participants that are not “key market participants.” ................................................................. 18

5. The final category should be “key market participants,” which should be read as equivalent to Swap Entities................................................. 18

E. The threshold that a party posting initial margin faces should be a function of its categorization, not that of its counterparty. ................................. 18
III. Baseline Minimum Amounts and Methodologies for Initial and Variation Margin

A. Initial margin should be calculated based on approved margin models or a standardized margin schedule, as agreed to by the counterparties posting margin. .............................................................. 20

1. Margin models should be independently verifiable and ideally made available to the counterparties whose margin requirements are calculated through the use of such models. ...................................................... 21

2. Where models are not used, initial margin calculations should be based on an approved grid. The grids proposed by the Prudential Regulators and BCBS/IOSCO strike the right balance between granular asset classes and flexibility, though certain changes are necessary. ................................................................................................. 22

3. If only one party posts initial margin, that party should be able to choose whether a model or a regulator-approved grid is used. If both parties post initial margin, they should jointly agree whether a model or grid is used. Market participants should be able to choose to use an approved model or the standardized grid for each asset class, but should not be able to “cherry pick” within each asset class. ................................................................................................................. 23

B. Portfolio margining should allow for risk offsets across any instruments or asset classes subject to the same master netting agreement so long as there is a “sound theoretical basis and significant empirical support,” as proposed by the Commission ........................................ 23

C. Liquidation time horizons for uncleared swaps should be set at a 99% confidence interval over a horizon of less than 10 days. .................................................. 24

IV. Eligible Collateral for Margin

A. Eligible collateral should include high-quality municipal securities, obligations of government-sponsored entities, certificates of deposit, commercial paper, high-quality corporate bonds, high-quality covered bonds, general obligations of sovereign nations, interest in money market mutual funds, each denominated in any major currency, and any other collateral eligible under the Consultative Paper. ................................. 25

V. Treatment of Provided Margin

VI. Treatment of Transactions with Affiliates

VII. Interaction of National Regimes in Cross-Border Transactions

A. A single jurisdiction’s margin requirements should apply to both counterparties to a swap. The counterparties should be able to agree
which of their jurisdiction’s margin requirements will apply, as long as both jurisdiction’s requirements are consistent with international standards.

* * *

Preliminary Timing Concerns

A. When phasing in uncleared swap margin requirements, regulators should keep in mind operational, business and logistical issues.

**BCBS/IOSCO Approach:** The Consultative Paper seeks input on the appropriate phase-in period for the implementation of margining requirements on non-centrally cleared derivatives.\(^6\)

**Commission and Prudential Regulators’ Approach:** Uncleared margin rules would become effective 180 days after the publication of the final rules in the Federal Register. The Commission has separately proposed a phase-in process through which margin requirements would become effective first for swap dealers, major swap participants and active funds, and later for other entities.

**Suggested Approach:** When phasing in uncleared swap margin requirements, regulators should keep in mind operational, business and logistical issues. Specifically:

1. Uncleared margin rules should only become effective once all models submitted within the first 180 days after rule publication have been reviewed.

2. Uncleared margin collection rules should only become effective once all operational and documentation requirements for the uncleared margin requirements can be met.

3. Margin rules should only become effective for a particular swap after clearing is required for that swap, which will be a function of both the type of swap and the types of counterparties.

We note that SIFMA and AMG have commented extensively on the phase-in process for U.S. Title VII swap regulations generally and margin requirements more specifically. Here, however, we focus on the particular phase-in issues presented by margin requirements.\(^7\)

---

\(^6\) Consultative Paper at 5, Q. 1.

\(^7\) See Letter from SIFMA and ISDA to the Commodity Futures Trading Commission on the Proposed Schedule of CFTC Title VII Rulemaking (June 29, 2012), on file with Commission, also available at http://www.sifma.org/issues/item.aspx?id=8589939400; Letter from the FIA, ISDA and SIFMA to the Commodity Futures Trading Commission on the CFTC Proposed Compliance and Implementation Schedules for Clearing, Trade Execution, Documentation and Margin (Nov. 4, 2011),
1. **Uncleared margin rules should only become effective once all models submitted within the first 180 days after rule publication have been reviewed.**

   The AMG believes that uncleared margin rules should only become effective once all margin models submitted within an appropriate amount of time after margin rules are published have been reviewed. If uncleared margin is required before pending internal models are reviewed, counterparties to entities whose models have been submitted but are awaiting approval by the appropriate regulator will be forced to post initial margin as calculated under the applicable fallback approach, which the AMG believes would most likely yield a larger margin requirement than would be calculated under approved models. This result would be unnecessarily punitive to both counterparties. Accordingly, AMG asks that effectiveness be delayed until all models submitted by market participants within 180 days after rule publication have been reviewed by the relevant regulators.

2. **Uncleared margin rules should only become effective once all operational and documentation requirements for the uncleared margin requirements can be met.**

   The move to an uncleared swap margin regime will raise significant operational issues and requirements. Firms will have to develop margin collection and posting systems, develop and test models and develop and test new account systems, to the extent this infrastructure is not already in existence. Unexpected issues are sure to arise. As a result, regulators must be sure to provide market participants with sufficient time to work out these operational issues to avoid introducing, rather than reducing, risk through the introduction of uncleared swap margin requirements.

   Significant documentation work will also be required. For example, many firms newly subject to initial margin requirements will need to set up tri-party accounts and agreements. At present, many clients of AMG members do not post initial margin to their swap counterparties. If these parties are newly required to post initial margin, they will need time to make appropriate arrangements with tri-party custodians to protect this collateral from counterparty risk. Requiring the margin rules to come into effect before these tri-party contracts are in place will effectively force those entities to assume counterparty risk until the agreements are in place.

3. **Margin rules should only become effective for a particular swap after clearing is required for that swap, which will be a function of both the type of swap and the type of market participant.**

   If regulators, both in the United States and internationally, phase in swap clearing requirements by category of swap or by market participant, the uncleared margin rules for a particular swap should not become effective until such swap is required to be cleared available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49954&SearchText=; Letter from the FIA, the Financial Services Forum, ISDA and SIFMA to the Commodity Futures Trading Commission and the Securities and Exchange Commission on the Phase-In Schedule for Requirements for Title VII of the Dodd-Frank Act (May 4, 2011), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50175&SearchText=. 
for that particular market participant. Subjecting all swaps, including those that are not required to be cleared, to margin requirements is unnecessarily punitive. In addition, we suggest that if regulators establish different implementation timelines for clearing by different market participants, then the uncleared margin rules should not become effective for a given participant until clearing is mandated for such participant for that particular category of swap.

B. Pre-effective swaps should only be used in margin calculations if both counterparties agree to do so.

**BCBS/IOSCO Approach:** The Consultative Paper is silent on the treatment of swaps entered into before the effectiveness of the margin requirements ("pre-effective swaps").

**Commission Approach:** Margin requirements would apply only to swaps entered into after the rules become effective.

**Prudential Regulators’ Approach:** Pre-effective swaps would be subject to margin requirements at the election of the regulated entity.

**Suggested Approach:** Margin requirements should apply to pre-effective swaps only if both parties agree to do so.

The AMG believes that parties to swaps entered into prior to the effectiveness of the margin rules should not be required to include those swaps in post-effective margin calculations, but should be permitted to only if both parties agree to do so. We believe that retroactively imposing a margin requirement on swaps entered into before the effectiveness of margin regulation unfairly alters the economic arrangement originally agreed to in the swap. For the same reason, we believe that neither counterparty should unilaterally be allowed to decide that pre-effective swaps will be included in margin calculations.

I. Scope of Coverage – Instruments Subject to the Requirements

A. “Foreign exchange swaps” and “foreign exchange forwards” should not be subject to margin requirements.

**BCBS/IOSCO Approach:** All uncleared OTC derivatives, including foreign exchange instruments that might not be subject to mandatory clearing requirements, should be subject to margin requirements.

**Commission and Prudential Regulators’ Approach:** Under Dodd-Frank, all uncleared “swaps” (i.e., derivatives) to which a swap dealer or major swap participant is a counterparty should be subject to margin requirements. If the Treasury Secretary exempts “foreign exchange swaps” and “foreign exchange forwards” from the definition of “swap,” margin requirements will not apply to these instruments.

**Suggested Approach:** Foreign exchange swaps and foreign exchange forwards should not be subject to margin requirements. All other uncleared OTC derivatives to which a
swap dealer or major swap participant is a counterparty should be subject to margin requirements.

The AMG believes that, worldwide, margin requirements should not apply to foreign exchange swaps and forwards ("FX Products"). We believe that FX Products pose less risk than other swaps and, because these risks are appropriately mitigated today, FX Products should not be subject to mandatory margin requirements.

The Consultative Paper notes that margin requirements for non-centrally-cleared derivatives should have two main benefits: promotion of central clearing and reduction of systemic risk. Applying margin requirements to FX Products would serve neither of these two goals. First, a margin regime that incentivizes central clearing for FX Products is not appropriate because the operational difficulties that central clearing would create outweigh the limited reduction in risk that would result from clearing. Any mandatory margin regime that seeks to incentivize clearing will therefore be punitive to FX Products by raising costs of legitimately trading these products in a bilateral, uncleared world. As a result, many participants globally will find it much more expensive to do basic transactions in the currency market, especially those using FX Products to hedge risks and adjust timing of currency payments and deliveries to match their business needs; even if exempt from a margin regime as end-users, these costs will likely be passed down to them.

Second, discouraging activity in FX Products will not reduce systemic risk, as global settlement systems such as CLS Bank already serve this purpose. FX Products have low replacement cost risk relative to settlement risk. CLS Bank has already essentially eliminated the settlement risk for those participants that utilize its settlement system. In addition, subjecting FX Products to an additional regulatory regime could undermine continuing efforts of central banks to reduce settlement risk in the foreign exchange market. In essence, a mandatory margin regime will distract participants from further reducing settlement risk and transaction costs in an effort to reduce replacement cost risk.

While the AMG believes that the above reasoning supports the exclusion of all FX swaps and forwards from any mandatory margin regime, at a minimum we wish to stress that application of a mandatory margin regime to the deliverable FX Products would be particularly inappropriate. This is the case because deliverable FX Products will not be

---

8 Consultative Paper at 2.

9 BCBS/IOSCO ask whether “foreign exchange swaps and forwards with a maturity of less than a specified tenor such as one month or one year [should] be exempted from margining requirements due to their risk profile, market infrastructure, or other factors.” Id. at 14. As stated above, we believe that all FX Products should be excluded from uncleared margin requirements. Any mandatory margin regime based on tenor will incentivize institutions to hedge their currency risk using shorter-dated FX Products for which margin is not required and be subject to greater FX currency risk than desired. However, if BCBS/IOSCO do not find it appropriate to exclude all FX Products, we believe that at the least FX Products with a maturity of less than one year should be exempt. Such short-term FX Products do not pose the kinds of risk intended to be addressed by the mandatory clearing requirements, and in the uncleared context, required margin create burdens outweighing any potential risk reduction benefit.
required to clear in the United States if the U.S. Treasury Secretary exempts such products, as proposed, a determination that we support for the reasons stated above. Consequently, subjecting deliverable FX Products to mandatory margin requirements would not serve the goal of incentivizing clearing, one of the two goals of the Consultative Paper. Thus, at a minimum, we do not believe that deliverable FX Products should be subject to mandatory margin requirements.

II. Scope of Coverage – Scope of Applicability

A. Margin requirements should be bilateral, unless the end user party elects not to require such margin from its counterparty.

| BCBS/IOSCO Approach: Margin requirements should be bilateral; both entities to a covered derivative should be required to post margin to each other. |
| Commission and Prudential Regulators’ Approach: Swap Entities are required to collect margin but not required to post margin. |
| Suggested Approach: Margin requirements should be bilateral, unless the end user party elects not to require such margin from its counterparty. |

The Consultative Paper proposes that margin should be exchanged bilaterally and that “all covered entities (i.e., financial firms and systemically important non-financial entities) that engage in non-centrally-cleared derivatives must exchange initial and variation margin as appropriate to the risks posed by such transactions.”10 By contrast, the U.S. Proposals require Swap Entities to collect, but not to post, margin.11 The Consultative Paper notes that “[t]here was broad consensus within the BCBS and IOSCO that all covered entities engaging in non-centrally-cleared derivatives must exchange initial and variation margin.”12 We strongly support this conclusion on the part of BCBS/IOSCO, and we urge the Commission to align its views with those of the international regulators, requiring the bilateral posting of margin for all uncleared swap transactions.

The AMG believes that variation margin requirements for uncleared swaps should be bilateral and that, to the extent that regulators require swap dealers and similar entities to collect initial margin, they should also require these entities to post margin to their counterparties unless the counterparty elects not to require such margin. Doing so would promote BCBS/IOSCO’s two primary goals for margin requirements. First, bilateral margining promotes central clearing. If margin requirements are unilateral, it could be in the dealer’s financial interest to enter into uncleared swaps for which, in contrast to cleared swaps, they would not be required to post margin. Second, bilateral margining is

10 Id.

11 See Commission Proposal at 23,744 (to be codified at 17 C.F.R. § 23.152, .153 and .154) (in each instance phrasing all initial margin and variation margin requirements in terms of what each Swap Entity shall require of its counterparty, whether that counterparty is a Swap Entity, financial entity or a non-financial entity).

consistent with the Consultative Paper’s goal of reduction of systemic risk,\textsuperscript{13} since, to the extent margin is needed to protect the financial system from cascading cross-defaults, it is important that the obligations of both sides be secured. If swap dealers and similar entities are not required to post margin to financial end users of swaps, such as AMG members, the failure of even one such swap dealer could cause ripple effects throughout the financial system. In addition, mitigation of credit risk through bilateral margining is as important to financial end users as it is to their counterparties.

We believe, however, that financial end users should be able to elect not to collect initial margin from their counterparties based on an analysis of the counterparty’s creditworthiness and whether, given such creditworthiness, collecting initial margin might be operationally difficult or make swaps unnecessarily costly.

B. Variation margin should be collected daily.

<table>
<thead>
<tr>
<th>BCBS/IOSCO Approach</th>
<th>No timing for variation margin collection is suggested, but comment on the issue is sought.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission and Prudential Regulators’ Approach</td>
<td>Variation margin should be collected once per day for high-risk end users and once per week for low-risk end users.</td>
</tr>
<tr>
<td>Suggested Approach</td>
<td>Variation margin should be collected and posted by both parties on a daily basis, allowing for operational delays.</td>
</tr>
</tbody>
</table>

The Consultative Paper does not offer a concrete suggestion as to the timing for the collection of variation margin. Rather, BCBS/IOSCO seek comment as to the frequency with which variation margin should be collected.\textsuperscript{14} The AMG believes that variation margin calls should be made on a daily basis. This requirement will ensure parity of treatment between counterparties and help to preserve market stability and liquidity by preventing a situation where a significant level of exposure accrues over a week’s time and requires a large settlement amount, instead limiting exposure levels by more frequent variation margin cycles. We note that, by daily collection, we mean that variation margin would be called for daily, relative to the previous day’s changes in current exposure. Posting of the margin, however, should be accomplished on a normal operational timeframe relative to the time of call—typically T +1 or T + 2.

C. Each party to a swap should be provided a sufficient period of time after execution of the swap to collect margin from its counterparty.

| BCBS/IOSCO Approach | Initial margin should be collected at the outset of the transaction. No specific timing for the collection of variation margin is suggested. Initial margin should be collected “at the outset of a transaction,” and any disputes regarding initial or variation margin should be resolved to allow for the collection of margin “in a timely fashion.” |

\textsuperscript{13} Id. at 2.

\textsuperscript{14} Id. at 21, Q. 17.
**Commission Approach:** Initial margin should be collected from financial end user counterparties on or before the date the swap is entered into. Variation margin collection should begin on the day after the swap is executed.

**Prudential Regulators’ Approach:** Initial margin should be collected from financial end user counterparties on or before the date the swap is entered into. Variation margin collection should begin on the day the swap is executed.

**Suggested Approach:** Each party to a swap should be provided sufficient time after the execution of the swap to collect margin from its counterparty.

The AMG believes that each party to a swap should be provided a sufficient period of time after execution of the swap to collect margin from its counterparty. The AMG believes that the U.S. Proposals’ timing provision, which would require pre-funding of margin or nearly simultaneous swap execution and posting of margin, does not reflect the operational realities of the trading, payment and collateral transfer processes. These processes are far more complex for swaps than for the futures contracts upon which these timing proposals seem to be modeled, as in the futures context a clearing agent covers intraday margin calls and asks end users for margin the next day. The AMG believes that all regulators should appropriately account for these operational concerns.

Specifically, the AMG believes that margin calls for a swap executed on date T should not be required until T + 1, with the margin not required to be posted until T + 2. If a margin call is not made until the afternoon of T + 1, the posting party should be permitted an additional day (i.e., until T + 3) to post the margin. Of course, parties should be allowed to exchange margin payments prior to these deadlines if they agree to do so.

Often, a swap trade executed on T is recorded in systems on T, although (as is often in the case of asset managers) there may be a delay due to the need to allocate block trades among accounts. The trade executed on T is typically not reflected in the portfolio for margin purposes until T + 1. The mark-to-market for the trade, used to calculate variation margin payments on T + 1, is struck as of the close of business on T through an overnight batch process. Margin calls are then generally made in the morning on T + 1, and delivery is required by T + 2. There must be at least one day between when a margin call is made and when the margin is posted because custodian banks have cutoffs for same-day delivery, some as early as 10:00 a.m. Our suggested timing is consistent with these operational realities, and is even shorter in some cases than the existing ISDA framework for margining uncleared swaps.

The need for additional time is especially critical when parties enter into swaps with counterparties in countries whose business days have very little overlap with theirs or their custodians’ because of time-zone differences, such as when financial end users in the United States enter into swaps with counterparties in Japan and Australia. Many of the ISDA credit support annexes commonly agreed upon by financial end users and their swap counterparties already take these operational requirements and timing concerns into account.
These timing requirements should not apply when the counterparties to a swap have a bona fide dispute over margin calls. ISDA Master Agreements typically provide for dispute rights, under which swap counterparties verify that margin calls are for an expected amount and will contest any margin call with which they disagree while paying the agreed-to sum.\(^\text{16}\) Resolving these disputes takes time, and counterparties should not be considered in violation of rules for not posting the full amount of margin during the pendency of the dispute. Instead, we believe that the U.S. Regulators should follow the example of the Consultative Paper and specifically account for the time needed to resolve any disputes. We note that this approach would be consistent with the recent Commission final rule regarding swap documentation, which requires 1) that swap documentation include any agreed-upon terms for dispute resolution and 2) each swap dealer or major swap participant (together “Swap Entity”) establish, maintain and follow policies and procedures reasonably designed to resolve discrepancies in portfolio valuation within five business days when facing another Swap Entity or “in a timely fashion” when facing a non-Swap Entity.\(^\text{17}\) These rules do not establish immutable deadlines for dispute resolution. Rather, they recognize that dispute resolution takes time and require only that Swap Entities plan ahead in order to address any disputes that arise as quickly as reasonably possible.\(^\text{18}\)

D. Regulators should divide financial entities into five categories, to which different thresholds apply (in decreasing order): (i) regulated low-systemic risk entities, (ii) prudentially-regulated entities, (iii) low-risk financial entities, (iv) other entities (other than key market participants) and (v) key market participants.

---

BCBS/IOSCO Approach: The Consultative Paper proposes up to three categories of financial entities to which different thresholds may apply: prudentially-regulated entities, “key market participants” and entities that are neither.

Commission and Prudential Regulators’ Approach: The U.S. regulators propose three categories of financial entities to which different thresholds may apply: Swap Entities, high-risk financial end users and low-risk financial end users.

Suggested Approach: Regulators should divide financial entities into five categories to which different thresholds apply (in decreasing order):

- regulated low-systemic risk entities, defined as entities that are subject to regulation that establishes capital or funding requirements or restricts the use of leverage;

---

\(^\text{16}\) For example, if a dealer calls for $3 in margin from a mutual fund, and the mutual fund believes the margin call should be for $2, the mutual fund will usually post $2 in margin while disputing the remaining $1.


\(^\text{18}\) Id. at 55,931 (“Thus [Swap Entities] will not violate the rule if they fail to resolve a particular dispute within five business days, so long as they have followed their reasonably designed procedures.”).
prudentially-regulated entities;

- low-risk financial entities (that are not regulated low-systemic risk entities and are not prudentially-regulated entities), defined as entities that do not have “significant swaps exposure” and are minimally leveraged relative to net assets;

- all other entities (other than key market participants); and

- key market participants, which, in the United States, should be Swap Entities.

The Consultative Paper divides market participants into three categories to which different thresholds may apply: prudentially-regulated entities, “key market participants” and entities that are neither. This largely aligns with the approaches in the U.S. Proposals, which would divide market participants into Swap Entities (which we believe is roughly equivalent to “key market participants”), high-risk financial end users (which we believe is roughly equivalent to other market participants) and low-risk financial end users (which we believe is roughly equivalent to prudentially-regulated entities). In the Consultative Paper, allowable thresholds would be lowest for “key market participants”/Swap Entities, highest for prudentially-regulated/low-risk financial entities, and in between for others/high-risk financial entities. While we agree with the general approach of allowing for higher thresholds for entities that are highly regulated or otherwise pose less risk, we believe that five categories, rather than three, are necessary.19

1. The first category should be regulated low-systemic risk entities, defined as entities that are subject to any regulation that establishes capital or funding requirements or restricts the use of leverage. Such entities should not be required to post initial margin, or in the alternative, should have very high thresholds.

The Consultative Paper asks whether there are “any specific exemptions that would not compromise the goal of reducing systemic risk and promoting central clearing that should be considered.”20 We believe that there are certain entities that should be exempt from initial margin requirements. Specifically, there are entities that, although not prudentially regulated, are otherwise subject to regulation that establishes capital or funding requirements, restricts the use of leverage or requires prudent diversification. These entities pose so little credit risk to their counterparties, and so little systemic risk to the financial system, that regulators should not require them to post any initial margin. In fact, participation by these entities in the financial markets can be viewed as reducing system risk since they are stable counterparties for other market participants. Below, we provide three examples of such similarly-regulated entities and the regulation that gives rise to the need for such treatment:

---

19 We note that the Consultative Paper and the U.S. Proposals largely, if not completely, exclude non-financial end users from proposed margin requirements.

• **RICs and Retail UCITS.** Registered investment companies (“RICs”), like their counterparts in Europe, retail Undertakings for Collective Investment in Transferable Securities (“UCITS”), are subject to a number of important regulatory requirements that minimize their risk profile as swap counterparties. Under longstanding interpretations of the Securities and Exchange Commission (“SEC”) and the staff of the SEC’s Division of Investment Management, instruments that create explicit or implicit leverage are deemed prohibited as the issuance of a senior security, unless the RIC (i) segregates or earmarks cash, liquid securities or other liquid assets on its books at its custodian in an amount that, together with amounts deposited as margin, is at least equal to the fund’s obligation under such instrument, and marks to market daily, or (ii) holds an offsetting position. This requirement has the effect of limiting the leverage that a RIC can undertake via swaps and causing RICs to be low-leveraged entities generally. RICs are also subject to significant requirements and restrictions relating to their investments, capital structure and governance, including board oversight; counterparty liquidity and diversification requirements; compliance oversight; and disclosure, valuation and reporting requirements. Moreover, RICs are required to calculate and publish their net asset value and must disclose substantial information regarding their investment strategies to the SEC. Finally, RICs’ boards of trustees must adopt substantial compliance programs. These regulatory requirements make RICs very low-risk counterparties to swap transactions.

• **ERISA Funds and Government Plans.** ERISA funds face a similarly comprehensive regulatory regime that makes them minimally risky swap counterparties. ERISA funds must be prudently diversified. Plan fiduciaries must act solely in the interest of the plan’s participants and beneficiaries with the care, skill, prudence and diligence that a prudent person familiar with such matters would use. ERISA plans must be minimally leveraged, must have their assets held in trust, must disclose their holdings annually to the Department of Labor (“DOL”) and must meet stringent funding requirements under the Pension Protection Act of 2006. Investment managers of ERISA funds are subject to stringent regulations governing fiduciary duties and standards of care. There is no provision under any law for ERISA plans

---


22 ERISA § 404(a)(1)(B).

23 at § 403(a).

24 See Department of Labor Form 5500.

25 See ERISA § 3(38) (describing general requirements for investment managers); id. at § 404(a) (detailing investment managers’ fiduciary standards); id. at § 405 (establishing co-fiduciary liability); id. at § 409 (establishing fiduciary liability).
to file for bankruptcy or reorganization to avoid their financial obligations to counterparties, and the filing of bankruptcy by an ERISA plan sponsor or the involuntary termination of the plan does not relieve a plan of its financial obligations to counterparties. The historical stability of ERISA funds is demonstrated by the fact that these funds have met their swap obligations to dealers despite every significant financial event since the adoption of ERISA in 1974. With this comprehensive regime in mind, the Commission has relied on the pervasive regulation of ERISA plans and plan fiduciaries as a reason that it does not need to regulate these plans and Congress exempted pension trusts from SEC registration and regulation of “investment companies.” As a result, ERISA plans are minimally risky swap counterparties. While government benefit plans sponsored by U.S. federal, state and local governments are not subject to ERISA, they are subject to many of the same requirements and constraints under other applicable rules and, as a result, should be treated the same as ERISA plans.

- Other Foreign Pension Plans. Foreign pension plans are, in many cases, subject to comparable oversight as the above examples and should therefore also be exempt from initial margin requirements. For example, European Union (“EU”) pension funds are subject to extensive regulatory oversight pursuant to Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement (the “IORP Directive”), as well as the pension acts and associated regulations of each EU Member State. For example, under Article 18 of the IORP Directive, EU pension plan managers have fiduciary obligations to plan beneficiaries and generally must invest according to the “prudent investor rule.” More specifically, the IORP Directive prescribes that investments should be properly diversified and predominantly invested on regulated markets. Moreover, pension plans are prohibited from borrowing or acting as guarantor on behalf of third parties. With respect to derivatives, Article 18(1)(d) of the IORP Directive restricts EU pension funds from using OTC derivatives for any purpose other than to manage risks associated with their long-term liabilities. In addition, Article 18(1)(d) only permits derivative transactions “insofar as they contribute to a reduction of investment risks or facilitate efficient portfolio management,” and it further requires EU pension plan managers to “avoid excessive risk

26 Investment Company Act of 1940 § 3(c)(11).
28 Id., art. 18(1)(a), at 18.
29 Id., art. 18(1), at 18.
30 Id., art. 18(1)(e)–(f), at 19.
31 Id., art. 18(1)(c), at 19.
32 Id., art. 18(2), at 19.
33 Id., art. 18(1)(d), at 19.
exposure to a single counterparty and to other derivative operations.”  

In addition to the requirements of the IORP Directive, EU pension funds are further subject to Directive 2004/39/EC on markets in financial instruments.  

While these are only examples, we believe that they, at a minimum, should be considered “regulated low-systemic risk entities” and subject to no initial margin requirements.  In the alternative, if initial margin is required from these entities, we believe that they should be subject to very high thresholds.

2. The second category should be “prudentially-regulated entities.”

We agree with BCBS/IOSCO that the regulatory oversight of prudentially-regulated entities makes these entities less-risky counterparties and, as a result, prudentially-regulated entities that are not otherwise “key market participants” (i.e., in the United States, Swap Entities) should be subject to greater initial margin thresholds than certain other types of entities.

If BCBS/IOSCO and the U.S. Regulators choose not to create a category of “regulated low-systemic risk entities” that are not required to post initial margin, we believe that the entities listed above, including RICs and UCITS, ERISA funds and government plans and other foreign pension plans, should be subject to the same initial margin thresholds as prudentially-regulated entities, therefore, this category should then include similarly-regulated entities.  This would be appropriate because such entities are subject to a level of regulation at least as stringent as that of prudentially-regulated entities.

3. The third category should be “low-risk financial end users” (that are not regulated low-systemic risk entities and are not prudentially-regulated entities), defined as entities that do not have “significant swaps exposure” and are minimally leveraged relative to net assets.

We believe a fourth category, with a higher initial margin threshold than the previous three but lower than the next two, should exist for those financial end users that do not pose significant risk to their counterparties, yet are not regulated in a way that would allow them to be treated as a “regulated low-systemic risk entity” or a “prudentially-regulated entity,” as described above.  We believe that this category should consist of entities that do not have “significant swaps exposure” and are minimally leveraged relative to net assets.  For this test, “significant swaps exposure” would be, as in the U.S. Proposals, defined as half of the threshold that would make a person a “major swap participant” under the second prong of the joint Commission and SEC proposed definition.  Entities that are below this threshold and have very little leverage relative to net assets are less likely to default if the market moves against their position.

---

34 Id.

We believe that this “low-risk” definition should not depend on whether the financial end user enters into swaps for hedging purposes, an element of the current test under the U.S. Proposals. We believe that the entity’s creditworthiness, rather than the way in which it uses swaps, is the key determinant of the risk it poses to its counterparty.

4. **The fourth category should be all other market participants that are not “key market participants.”**

We believe that all other market participants, other than the key market participants described below, should be subject to an initial margin threshold that is smaller than the three preceding categories.

5. **The final category should be “key market participants,” which should be read as equivalent to Swap Entities.**

The Consultative Paper suggests that key market participants will include “large, internationally active derivative market participants that intermediate a significant portion of such derivatives and are important to the overall stability of the market.” These entities “may pose more systemic risk to the system in the event of significant number of counterparty defaults (e.g., as a result of a period of financial stress) and have market-wide consequences.” Based on this language, we believe that the concept of “key market participant” would largely overlap with Swap Entities in the United States. For the sake of consistency, however, we believe that both BCBS/IOSCO and the U.S. Regulators should clarify that these terms are designed to capture the same universe of entities—namely those whose volume of market activity would satisfy the standards for registration as a Swap Entity.

**E. The threshold that a party posting initial margin faces should be a function of its categorization, not that of its counterparty.**

**BCBS/IOSCO Approach:** Thresholds would be allowed for initial margin, but not variation margin. The Consultative Paper proposes several possible models, under which the counterparty’s status as non-prudentially-regulated, prudentially-regulated or a key market participant would govern initial margin thresholds. Under any of these models, the lower threshold requirement of the two counterparties would apply.

---

36 Consultative Paper at 10.
37 *Id.*
38 Registration as a Swap Entity will only be required of entities transacting in a significant volume of swap activities. For swap dealers, the initial registration threshold is $8 billion in notional amount of dealing activity in a 12-month period or $25 million with special entities. Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 Fed. Reg. 30,596, 30,744 (to be codified at 17 C.F.R. § 1.3(ggg)(4)). For major swap participants, registration will be required for an entity that is not a swap dealer but meets certain very high thresholds of swap exposure. *Id.* at 30,746 (to be codified at 17 C.F.R. § 1.3(hhh)(1)).
Commission and Prudential Regulators’ Approach: No thresholds would be allowed for trades between Swap Entities or trades between a Swap Entity and a high-risk financial end user. Trades between a Swap Entity and a low-risk financial end user would be permitted to have initial and variation margin thresholds up to the lesser of (a) a specific dollar amount between $15 million and $45 million (to be set in the final rule) and (b) a percentage of the Swap Entity’s capital between 0.1% and 0.3% (to be set in the final rule). As margin requirements are unilateral rather than bilateral, there is no discussion of whose margin requirements should apply.

Suggested Approach: No variation margin thresholds should be available. With respect to initial margin, where two parties of different status face each other, each should post subject the threshold appropriate to its status. The size of the initial margin threshold should decrease in the following order: (i) regulated low-systemic risk entities (for whom there should be an unlimited threshold), (ii) prudentially-regulated entities, (iii) low-risk financial entities, (iv) other entities (other than key market participants) and (v) key market participants.

The AMG does not believe that variation margin thresholds are necessary. Variation margin reflects actual swap exposure and, unlike initial margin, is not meant to be an additional cushion in case of counterparty default. Today, both parties to a swap typically post variation margin to each other without thresholds. AMG members do not think it is appropriate for financial end user counterparties to be less protected under the final margin rules than many are today.

With respect to initial margin, the AMG believes that the size of the initial margin threshold should decrease in the following order: (i) regulated low-systemic risk entities (for whom there should be an unlimited threshold), (ii) prudentially-regulated entities, (iii) low-risk financial entities, (iv) other entities other than key market participants and (v) key market participants. As stated in our prior letter on the U.S. Proposals, we believe that the maximum uncollateralized threshold for low-risk financial end users should be set at $100 million. We believe that this would be an appropriate threshold for the “low-risk financial entities” and serve as an appropriate calibration point for the other four categories.

We disagree with the Consultative Paper’s approach that counterparties should be subject to the same thresholds, even when the two counterparties come from different classes of market participant. Instead, a counterparty should be subject to threshold limits based on its own market participant status, regardless of the thresholds applicable to the other party. Initial margin is intended to protect each counterparty from the risk default posed by the other counterparty. Consequently, it is appropriate that the thresholds governing posting of initial margin should be differentiated by counterparty classification, reflecting that different classes of market participants pose different levels of risk. For example, a prudentially-regulated entity poses the same risk to its counterparty regardless of whether that counterparty is itself prudentially-regulated or, instead, is a more risky counterparty. Further, we believe that requiring a party to post margin with a threshold that depends on its counterparty’s creditworthiness will distort
the choice of counterparties, increasing systemic risk by encouraging market participants
to trade with those counterparties with thresholds that are the same or higher than theirs.

III. Baseline Minimum Amounts and Methodologies for Initial and Variation Margin

A. Initial margin should be calculated based on approved margin models or a
standardized margin schedule, as agreed to by the counterparties posting margin.

<table>
<thead>
<tr>
<th>BCBS/IOSCO Approach</th>
<th>Initial margin requirements may be calculated based on approved quantitative portfolio margin models or a standardized margin schedule. Market participants may choose to use an approved model or the standardized schedule for each asset class, but may not “cherry pick” within each asset class.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission Approach</td>
<td>Initial margin requirements may be calculated based on approved margin models or standard calculations using comparable cleared swaps or futures.</td>
</tr>
<tr>
<td>Prudential Regulators’ Approach</td>
<td>Initial margin may be calculated based on approved margin models or based on a standardized margin schedule.</td>
</tr>
<tr>
<td>Suggested Approach</td>
<td>Initial margin should be calculated based on approved margin models or a standardized margin schedule, as agreed to by the counterparties posting margin. In particular:</td>
</tr>
<tr>
<td></td>
<td>1. Margin models should be independently verifiable and ideally made available to the counterparties whose margin requirements are calculated through the use of such models.</td>
</tr>
<tr>
<td></td>
<td>2. Where models are not used, initial margin calculations should be based on an approved grid. The grid proposed by the Prudential Regulators and BCBS/IOSCO strikes the right balance between granular asset classes and flexibility, though certain changes are necessary.</td>
</tr>
<tr>
<td></td>
<td>3. If only one party posts initial margin, that party should be able to choose whether a model or a regulator-approved grid is used. If both parties post initial margin, they should jointly agree whether a model or grid is used. Market participants should be able to choose to use an approved model or the standardized grid for each asset class, but should not be able to “cherry pick” within each asset class.</td>
</tr>
</tbody>
</table>

The Consultative Paper proposes that initial margin should be based on either a quantitative portfolio model or a standardized margin schedule.39 The Paper stresses that although market participants should have autonomy in determining the methods used to calculate margin requirements, they should not be allowed to switch back and forth over

---

39 *Id.* at 17.
time in an attempt to “cherry pick” the best initial margin terms but, rather, should be held to consistent choices for all transactions within a defined asset class.40

The U.S. Proposals offer approved quantitative models as an appropriate methodology for calculating margin requirements. Where models are not available, the Prudential Regulator Proposal provides for use of a standardized margin grid.41 The Commission, however, suggests an alternative method of initial margin calculation in the absence of an approved model.42 The Commission’s alternative method requires identifying the cleared swap in the same asset class “for which the terms and conditions most closely approximate the terms and conditions of the uncleared swap,” or, if no such analogous cleared swap exists, the most closely analogous futures contract. The margin collector would then multiply the margin required on the analogous cleared swap by 2 or the analogous futures contract by 4.4 to arrive at the initial margin requirement for the uncleared swap.

1. Margin models should be independently verifiable and ideally made available to the counterparties whose margin requirements are calculated through the use of such models.

The AMG agrees that the use of quantitative margin models is appropriate, subject to regulatory approvals. The AMG believes, however, that margin models, whether proprietary models, clearinghouse models or vendor models, must allow financial end users to independently verify the calculation of initial margin. Otherwise, financial end users will face a “black box” that will not allow them to predict their margin requirements. To this end, the AMG supports the provision in the Commission Proposal that would require all approved models to be “stated with sufficient specificity to allow the counterparty, the Commission, and any applicable prudential regulator to calculate the margin requirement independently.”43

However, we believe this does not go far enough and believe it would be ideal for the Commission to require sharing with a counterparty to a swap the approved margin model used to calculate that counterparty’s margin requirement, so that the counterparty can ensure the model is being used appropriately. We also believe this requirement should be extended to clearinghouse and vendor models. We note that making approved margin models available to counterparties would serve to increase transparency and promote accountability from the entities whose models are being used, who are in many instances better situated to hold dealers accountable than regulators.

Separately, the AMG requests that the Commission, the Prudential Regulators and BCBS/IOSCO clarify in their respective rules that the use of a model will not in any

40 Id. at 17.
41 Prudential Regulator Proposal at 27,592.
42 Commission Proposal at 23,747, § 23.155(c)(1).
respect impair the parties’ recourse under any contractual dispute resolution provision in
the relevant transaction documentation or master netting agreement.

2. Where models are not used, initial margin calculations should be based on an approved grid. The grids proposed by the Prudential Regulators and BCBS/IOSCO strike the right balance between granular asset classes and flexibility, though certain changes are necessary.

The AMG believes that a grid-based approach is superior to alternative approaches to non-model margin calculation, such as the Commission’s alternative calculation option. The Commission’s alternative system could lead to significant uncertainty about how to choose the appropriate reference instrument and, thus, hinder the uniform application of initial margin calculations more generally. A standard grid approved by regulators internationally, which would express initial margin requirements as a percentage of the swap notional amount, depending on asset class,44 has the advantage of relative simplicity and predictability, as counterparties can calculate notional amounts quickly and accurately.

The AMG believes that the grids proposed by the Prudential Regulators and BCBS/IOSCO strike the right balance between granular asset classes and flexibility. While it might be preferable to include an expanded number of asset classes to focus on precise, rather than generic, categories of swaps, it is impractical to attempt to provide specific prescriptions with respect to each of the almost unlimited number of swaps products. While a more finely calibrated grid would be more risk-sensitive than one in which the categories are overly broad, the AMG expects that the majority of trading relationships will be governed by approved model-based calculations, with the grid only relevant when chosen by the parties to a swap.

However, the AMG believes that no initial margin requirement should apply to a party that has no additional payment obligations under a swap that has not yet matured. For example, no initial margin requirements should apply to the owner of an option who has fully paid the related premium.45 Because initial margin is meant to serve as a buffer against default of the posting party for payment obligations, it is unnecessary when no such obligations do or can exist. Further, the AMG believes that any regulator-approved grid should allow two offsetting swap positions to be netted against each other, as is allowed under the Consultative Paper.46

---

44 Prudential Regulator Proposal at 27,592, Appendix A.

45 See Prudential Regulator Proposal at 27,573 (requesting comment on whether “swap or security-based swap positions that pose no counterparty risk to the covered swap entity, such as a sold call option with the full premium paid at inception of the trade, [should] be excluded from the initial margin calculation.”).

46 Consultative Paper at 18, n.13 (“As an example, one pay fixed interest rate swap with a maturity of 3 years and a notional of 100 could be netted against another pay floating interest rate swap with a maturity of 3 years and a notional of 50 to arrive at a single notional of 50 to which the appropriate margin rate would be applied.”).
3. If only one party posts initial margin, that party should be able to choose whether a model or a regulator-approved grid is used. If both parties post initial margin, they should jointly agree whether a model or grid is used. Market participants should be able to choose to use an approved model or the standardized grid for each asset class, but should not be able to “cherry pick” within each asset class.

As currently written, the U.S. Proposals allow a Swap Entity to choose whether initial margin requirements for its counterparties are calculated according to approved initial margin models or according to a specified alternative method. The Consultative Paper provides counterparties the choice to use its proposed margin schedule, rather than an approved grid, without specifically assigning the choice to a given counterparty. The AMG believes that if only one party is required to post initial margin, that party should have the option to elect whether a model or a regulator-approved grid will be used to calculate the initial margin amount. Otherwise, the collecting party pay chooses to maximize the amount of margin collected from its counterparty, regardless of the risk posed. If initial margin is posted by both parties, the AMG believes that the choice should be made by both parties together and should apply to both parties.

**B. Portfolio margining should allow for risk offsets across any instruments or asset classes subject to the same master netting agreement so long as there is a “sound theoretical basis and significant empirical support,” as proposed by the Commission.**

**BCBS/IOSCO Approach:** Portfolio margining may be applied to derivatives that are approved for model use and subject to a single, legally enforceable netting agreement. This margining may, subject to approval by the relevant supervisory authority, account for diversification, hedging and risk offset within but not across asset classes. These asset classes would include credit instruments, commodity instruments, equity instruments, foreign exchange / currency instruments, interest rate instruments and other instruments.

**Commission Approach:** Portfolio margining is permitted for margin models so long as there is a “sound theoretical basis and significant empirical support.”

**Prudential Regulators’ Approach:** Portfolio margining may be done within, but not across, asset classes. These asset classes would include credit instruments, commodity instruments, equity instruments, foreign exchange / currency instruments, interest rate instruments and other instruments.

47 Commission Proposal at 23,746, § 23.155(a)(2); Prudential Regulator Proposal at 27,587, § __.2(k).

48 Consultative Paper at 19.

49 Commission Proposal at 23,746 (to be codified at 17 C.F.R. § 23.155(b)(2)(v)).
**Suggested Approach:** Portfolio margining should allow for risk offsets across any instruments or asset classes subject to the same master netting agreement so long as there is a “sound theoretical basis and significant empirical support,” as proposed by the Commission.

The AMG believes that models for calculating initial margin should allow for risk offsets across any instruments subject to the same, legally enforceable master netting agreement. The Consultative Paper would allow for risk offsets where the instruments involved are subject to a single, legally enforceable netting agreement but would not permit netting across asset classes. The Prudential Regulator Proposal permits an internal initial margin model to include risk offsets for swaps within, but not across, four broad asset class risk categories under the same master agreement.\(^50\) Under the Commission Proposal, risk offsets under an initial margin model seem to be allowed provided that they “have a sound theoretical basis and significant empirical support,” as proposed by the Commission.\(^51\)

The AMG believes that the calculation of initial margin should reflect the assessment of risk across asset classes within a trading portfolio as provided in a legally enforceable master netting agreement. Common trading practices recognize the risk-reducing relationship between cash positions and derivatives on related underliers or a combination of derivative types, each targeting a different component of the individual risks presented by the cash position. The calculation of initial margin should give full recognition to the risk-mitigating benefits arising from related trades across risk categories as well as across related derivatives and cash positions, as long as they are part of the same master netting agreement and there is a “sound theoretical basis and significant empirical support.”

The ability to enter into master netting agreements has long been recognized as an effective means to reduce or eliminate risks. Margin requirements imposed on counterparties should reflect this mitigation of risk. Failing to allow for these risk offsets will require both counterparties, in a bilateral margin context, to commit a greater amount of capital as margin rather than using it to make new investments, thus unnecessarily reducing overall returns.

**C. Liquidation time horizons for uncleared swaps should be set at a 99% confidence interval over a horizon of less than 10 days.**

**BCBS/IOSCO Approach:** Liquidation time horizons for uncleared swaps should be set at a 99% confidence interval over a 10-day horizon.

**Commission and Prudential Regulators’ Approach:** Liquidation time horizons for uncleared swaps should be set at a 99% confidence interval over a 10-day horizon.

---

\(^50\) Prudential Regulator Proposal at 27,590, § __.8(d)(3).

\(^51\) Commission Proposal at 23,746, § 23.155(b)(2)(v). The AMG requests that the Commission clarify that risk offsets can be used across all instruments, asset classes and netting agreements.
**Suggested Approach**: Liquidation time horizons for uncleared swaps should be set at a 99% confidence interval over a horizon of less than 10 days.

The AMG believes that the liquidation time horizons for initial margin models are unnecessarily long and should be shortened. The Consultative Paper and the U.S. Proposals all require that initial margin model calculations cover at least 99% of price changes over at least a ten-day liquidation time horizon.\(^{52}\) The AMG believes that the liquidation time period should instead be closer to five days than ten days. We believe that such a shorter period is sufficient to allow close-out, offset or other risk mitigation for uncleared swaps. We understand that the ten-day liquidation time horizon is meant to provide sufficient time for the non-defaulting party to replace its swap. However, the AMG believes that whether or not a swap is replaced (as opposed to substitution of other risk-mitigation or hedging transactions) is a business decision that should not be incorporated into rulemaking.\(^{53}\)

IV. **Eligible Collateral for Margin**

A. **Eligible collateral should include high-quality municipal securities, obligations of government-sponsored entities, certificates of deposit, commercial paper, high-quality corporate bonds, high-quality covered bonds, general obligations of sovereign nations, interest in money market mutual funds, each denominated in any major currency, and any other collateral eligible under the Consultative Paper.**

**BCBS/IOSCO Approach**: Eligible collateral should be highly liquid and able to hold value in periods of stress. This should include cash, high-quality government and central bank securities, high-quality corporate bonds, high-quality covered bonds, equities in major stock indices and gold.

**Commission and Prudential Regulators’ Approach**: Eligible collateral for transactions involving financial entities should include cash, instruments guaranteed by the United States or its agencies or obligations of government-sponsored entities.

**Suggested Approach**: Eligible collateral should include high-quality municipal securities, high-quality government and central bank securities, obligations of government-sponsored entities, certificates of deposit, commercial paper, high-quality corporate bonds, high-quality covered bonds, general obligations of sovereign nations,

---

\(^{52}\) See id. at 23,746, § 23.155(b)(2)(vi); Prudential Regulator Proposal at 27,590, § __.8(d)(1).

\(^{53}\) Similarly, we believe that the historical period used to calibrate initial margin models should be agreed upon by the counterparties to the swap. Currently, the Prudential Regulator Proposal and the Commission Proposal require internal initial margin models to be calibrated using at least one year of historic price data and to incorporate a period of “significant financial stress” that is appropriate for the swaps to which the models are applied. Prudential Regulator Proposal at 27,591, § __.8(d)(11); Commission Proposal at 23,746, § 23.155(b)(2)(iv). Volatility over a one-year period may not be reflective of current dynamics and, as a result, may not be a good indicator of the volatility that should be expected for the remaining life of the swap.
interest in money market mutual funds, and any other collateral eligible under the Consultative Paper, each denominated in any major currency.

The Consultative Paper’s key principle for eligible collateral states that assets collected as collateral should be highly liquid and able to hold value in a time of financial stress. To that end, the Paper proposes that the following examples would satisfy this key principle: cash, high-quality government and central bank securities, high-quality corporate bonds, high-quality covered bonds, equities included in major stock indices and gold. The AMG agrees with this key principle and believes that in general, the scope of proposed eligible collateral is appropriate. We would, however, add to the list the following: certificates of deposit, commercial paper, corporate notes and bonds, generally, and interests in money market mutual funds, each denominated in any major currency.

The AMG believes that all of these asset classes are liquid enough to facilitate the swift resolution of uncleared swap positions in the case of a counterparty default. First, restricting collateral only to certain narrow asset classes may create pressure on financial end users to hold different kinds of assets in reserve from what they normally would, artificially skewing their portfolios, introducing a drag on performance through transaction costs and shifting risk between different markets. Second, it might also increase or decrease demand for certain kinds of assets, including U.S. Treasuries, causing volatility in price and yield as market participants buy and sell these assets to meet collateral demands. Third, restricting the types of eligible collateral would force some market participants to engage in collateral transformation services that might include repurchase transactions and securities lending, which may concentrate risk in those markets.

The types of collateral allowed by the U.S. Proposals are inconsistent with, and much more restrictive than, those allowed by Commission Rule 1.25, for example by not allowing any segregated collateral to be invested in money market fund shares.

For purposes of debt, the determination of what is considered high-quality can be determined using option-adjusted spread (“OAS”), which generally measures a debt instrument's risk premium over benchmark rates covering a variety of risks and net of any embedded options in the instrument. For a particular fixed-income instrument, the OAS

54 Consultative Paper at 22.
55 Id.
56 The AMG is particularly concerned about this issue for some of its clients that primarily hold assets that are not considered eligible collateral, such as equity funds, real estate funds and emerging market debt funds.
57 Commission Rule 1.25 includes regulations involving permitted investment of customer funds. See 17 C.F.R. § 1.25 (“Investment of customer funds”).
58 However, the AMG believes, as noted to the Commission in our February 1 letter, that the classes of assets for which investment is permissible under Rule 1.25 are themselves too narrow. See Letter from Timothy W. Cameron, Managing Director, SIFMA AMG, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Feb. 1, 2011), on file with Commission and available upon request from AMG.
reflects the credit and liquidity risk net of any spread due to option features in the instrument and associated option risk. Because OAS can be calculated in a consistent manner for any fixed-income instrument relative to its benchmark rates, this method allows for comparison of fixed-income instruments across asset classes. The threshold for what constitutes a high-quality fixed-income instrument can be determined by setting a threshold OAS that is calculated in accordance with an approved method.

V. Treatment of Provided Margin

**BCBS/IOSCO Approach:** Initial margin should be exchanged by both parties on a gross basis and held in a manner that ensures both that (1) margin is immediately available to the collecting party in the event of the posting party’s default and (2) margin is protected in the event of the collecting party’s bankruptcy.

**Commission and Prudential Regulators’ Approach:** Initial margin must be segregated at an independent third party custodian for transactions between two Swap Entities; segregation is optional for transactions where one counterparty is an end user of any type. Segregated initial margin must be held at an independent third party custodian subject to the same insolvency law as the collecting Swap Entity. We believe this last requirement applies only to transactions between two Swap Entities. Rehypothecation is not permitted.

**Suggested Approach:** Swap counterparties should be able to elect that the margin they post be held at an independent, third-party custodian. In these cases, collateral should be able to be invested in eligible assets.

The Consultative Paper endorses the key principle that initial margin should be exchanged by both parties on a gross basis and held in a manner that ensures both that (1) margin is immediately available to the collecting party in the event of the posting party’s default and (2) margin is protected in the event of the collecting party’s bankruptcy. Following this principle, the Paper also proposes that “[c]ash and non-cash collateral collected as initial margin should not be re-hypothecated or reused.” Under the U.S. Proposals, initial margin must be segregated for transactions between two Swap Entities. However, segregation is optional for collateral posted by an end user counterparty of any type. Segregated initial margin must be held at an independent third party custodian subject to the same insolvency law as the collecting Swap Entity. We believe this last requirement applies only to transactions between two Swap Entities. Rehypothecation is not permitted.

We strongly believe that each counterparty to a swap that posts margin should be permitted, but not required, to elect to have their margin segregated at an independent, third-party custodian. In these cases, including when an independent third-party

---


60 Id.
custodian is used, collateral should be able to be invested in eligible assets.\textsuperscript{61} As an example, the investment of such segregated margin could be governed by the principles contained in the Commission’s proposed rule on the protection of collateral of counterparties to uncleared swaps.\textsuperscript{62} Under that proposal, the parties to a swap may agree to an arrangement regarding the investment of initial margin—and the allocation of gains and losses resulting from the investment—so long as those investments are consistent with the Commission’s rule 1.25.\textsuperscript{63}

VI. Treatment of Transactions with Affiliates

We are not offering any comments on this piece of the Consultative Paper.

VII. Interaction of National Regimes in Cross-Border Transactions

A. A single jurisdiction’s margin requirements should apply to both counterparties to a swap. The counterparties should be able to agree which of their jurisdiction’s margin requirements will apply, as long as both jurisdiction’s requirements are consistent with international standards.

<table>
<thead>
<tr>
<th>BCBS/IOSCO Approach:</th>
<th>Home-country requirements should apply to initial margin and variation margin. Home-country supervisors should permit host-country compliance as long as the host country’s regime is consistent with the Consultative Paper. A branch is treated as established in the home-country jurisdiction.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission Approach:</td>
<td>Commission-proposed cross-border guidance suggests that U.S. margin requirements would apply to all transactions by U.S. Swap Entities and all transactions by non-U.S. Swap Entities facing U.S. persons, non-U.S. persons guaranteed by U.S. persons, and non-U.S. affiliate conduits. Substituted compliance will be available where approved by the Commission.</td>
</tr>
<tr>
<td>Prudential Regulators’ Approach:</td>
<td>There is a narrow exception from compliance with the Prudential Regulators’ rules for foreign covered swap transactions with a foreign Swap Entity for foreign non-cleared swaps.</td>
</tr>
<tr>
<td>Suggested Approach:</td>
<td>A single jurisdiction’s margin requirements should apply to both counterparties to a swap. The counterparties should be able to agree which of their</td>
</tr>
</tbody>
</table>

\textsuperscript{61} Both U.S. Proposals currently contain provisions requiring, under certain circumstances, an independent third-party custodian holding margin for uncleared swaps to be located in a jurisdiction that applies the same insolvency regime to the custodian as to the Swap Entity for that swap. Commission Proposal at 23,748, § 23.158(a)(5); Prudential Regulator Proposal at 27,590, § __.7(d). The AMG does not believe that these provisions are meant to apply to swaps between financial end users and Swap Entities, but we would be opposed to any such requirement, given the tri-party collateral arrangements that clients of AMG members currently have in place.


\textsuperscript{63} Id. at 75,438 (to be codified at 17 C.F.R. § 23.603).
jurisdictions’ margin requirements will apply, as long as both jurisdictions’ requirements are consistent with international standards.

We believe that it is critical that market participants have complete legal certainty as to which margin requirements they will face in a particular transaction with a particular counterparty. While one of the goals of margin requirements for uncleared swaps is to reduce systemic risk, we note that legal uncertainty itself can give rise to an increase in systemic risk. We believe that the best way to achieve certainty is to subject both counterparties to a swap to the same margin requirements. In our view, as long as both counterparties’ jurisdictions’ margin requirements are consistent with international standards and each recognizes the other as sufficiently comparable, the two counterparties should be able jointly to choose at the outset of the transaction which of their jurisdictions’ law applies for margin purposes. Doing so will provide legal certainty without sacrificing either of the two goals that margin requirements are meant to achieve.

To the extent this suggestion is not followed, we believe that international regulators must keep practical considerations, as well as principles of comity, in mind. As a threshold matter, regulators are entitled to significant deference in circumstances where they are regulating the activities of locally domiciled entities. That deference is particularly appropriate where the regulatory mandate addresses the types of policy concerns that uncleared swap margin requirements seek to achieve.

* * * * *

The AMG appreciates the opportunity to provide the Commission, the Basel Committee on Banking Supervision, the Board of the International Organization of Securities Commissions and the Prudential Regulators with our comments and recommendations concerning the margin requirements for uncleared swaps. If you have any questions, please do not hesitate to call the undersigned at (212) 313-1289.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director
Asset Management Group
SIFMA

64 We note that this is consistent with the Consultative Paper’s suggestion that host-country margin requirements should be permitted to apply so long as “home-country supervisors consider[] the host-country margin regime to be consistent with the proposed margin requirements described in the paper.” Consultative Paper at 29.
cc: Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090