

10 July 2015

The European Securities and Markets Authority
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07, France
Attention: Steven Maijoor, Chair

The European Banking Authority
One Canada Square
Canary Wharf
London E14 5AA|UK
Attention: Andrea Enria, Chairperson

European Insurance and the Occupational Pensions Authority
Westhafenplatz 1
60327 Frankfurt am Main
Germany
Attention: Gabriel Bernardino, Chairman

Re: Second Consultation Paper regarding draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP

Ladies and Gentlemen,

The International Swaps and Derivatives Association¹ ("ISDA") welcomes this opportunity to respond to the Second Consultation Paper ("**Consultation Paper**") on the draft regulatory technical standards (the "**Draft RTS**") on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Art. 11(15) of Regulation (EU) No 648/2012 published by the European Securities and Markets Authority ("**ESMA**"), the European Banking Authority ("**EBA**") and European Insurance and the Occupational Pensions Authority ("**EIOPA**"), and together with ESMA and EBA, the European Supervisory Authorities, the "**ESAs**") on 10 June 2015.

¹ Since 1985, ISDA has worked to make the global over-the-counter ("OTC") derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Additional information on ISDA is available at www.isda.org.

INTRODUCTION

ISDA strongly supports the goals of strengthening systemic resiliency in the non-centrally cleared derivatives market by establishing risk mitigation techniques and margin requirements in accordance with the requirements of Regulation (EU) No 648/2012 ("**EMIR**"). In order to assist with the implementation of these requirements, we set out below our responses to the questions asked by the ESAs and raise other issues. Where appropriate, we suggest specific changes to the text of the Draft RTS.

The following issues are particularly important to our members:

Timing: The proposed timing for collection of collateral is too short.

Initial Margin in Cash: Cash should be eligible as initial margin if protected from the insolvency of the collecting party (and should not be subject to a requirement that the cash be protected from the insolvency of a custodian or third party holder.)

Cross-Border: The Draft RTS needs to accommodate trades with non-netting jurisdictions and to recognize the equivalency of the margin requirements of other jurisdictions.

Model: The use of risk sensitivities should be a clear option (as an alternative to assigning derivatives to asset classes) for the initial margin model.

Haircut: The Draft RTS should clearly state that the 8% currency mismatch haircut does not apply to cash initial margin or cash variation margin.

Definitions: For the purposes of this letter:

An "**NFC-**" is a non-financial counterparty as defined in EMIR other than one that is referred to in Art. 10 of EMIR.

"**IM**" is initial margin and "**VM**" is variation margin.

I. QUESTIONS RAISED IN THE CONSULTATION PAPER

In our responses throughout this letter, we provide specific proposals for the text of the Draft RTS. In the suggested text, language to be deleted is marked with a strikethrough and new or replacement language is underlined.

QUESTION 1. Treatment of Non-EU NFC- . Respondents are invited to comment on the proposal in this section [risk management procedures] concerning the treatment of non-financial counterparties domiciled outside the EU. (p. 27)

We welcome the change in the treatment of Non-EU NFC-s. We propose steps to address other cross-border implementation issues in this letter - see "II. ISSUE 1. Cross-Border" below.

QUESTION 2. Timing. Respondents are invited to comment on the proposal in this section [calculation and collection of margin] concerning the timing of calculation, call and delivery of initial and variation margins. (p. 31)

Suggested Language:

Art. 1 VM (2) – (5), (pp. 31, 32)

2. Variation margins shall be collected in one of the following ways:

(a) by settling exposures in cash;

(b) by collecting non-cash collateral in accordance with Section 3, subject to the haircuts requirements referred to in Section 4.

3. Variation margins shall be collected within ~~3 business days from the calculation date~~ the standard settlement cycle for the relevant collateral type after the call.

4. Variation margins shall be called one business day after the trade date, or if later, the earliest date on which variation margins can be calculated and responded to, which shall be no later than 2 business days after the trade date.

5. ~~For all netting sets where no initial margin is required, because of the potential exceptions of Section 1, Chapter 1 of this Regulation, the collection shall not exceed one business day.~~

Art. 1 EIM (3), (p. 32)

3. Counterparties shall ~~calculate and~~ collect the total amount of initial margins within the standard settlement cycle for the relevant collateral type after the call ~~one business day~~ following one of these events: ...

The initial margin call date shall occur one business day after the occurrence of the events listed above, or if later, the earliest date on which initial margin can be calculated, which shall be no later than 2 business days after the occurrence of the events listed above.

Explanation:

Collecting Cash VM.

Art. 1 VM (2)(a) refers to "settling exposures in cash" and Recital 11 (p. 19) includes similar language. We interpret this to mean "collecting cash in amounts sufficient to extinguish exposures", which would be consistent with current practice for collecting VM.

Timing.

We are concerned that the Consultation Paper does not allow enough time for collection of IM. The Consultation Paper provides that VM will be collected within 3 business days of calculation but only if IM is collected and there is an adjustment to the margin period of risk. (pp. 31 – 32, (3) – (6)) The Consultation Paper also provides that IM will be collected within one business day of the execution of a new OTC derivatives contract.

The Draft RTS needs to allow greater amounts of time for the call and collection of collateral and to address time zone issues.

Time Zone Issues: Many firms trade products that are marked to market in multiple regions. An example would be an entity trading Australian, Japanese, EU and US interest rate swaps or cross-currency swaps. The products will be marked in their respective time zones, for example Sydney close, Tokyo close, London close and New York close. The variation margin call will be the netted amount of the change in value of all of the contracts, and so can only be calculated once the trading books of the entity have closed in the last applicable time zone (which would be New York in the example above). The calculation will then be available to the operations team of the firm on the business day after trade date. For the margin call to be agreed between two firms, both operations teams must have performed the calculation.

For example, consider an Australian financial counterparty (with swap volumes below the IM threshold) with a euro trade versus a European financial firm. Based on Monday's closing value, the European firm will issue a margin call to the Australian firm on Tuesday at 8 a.m. CET. However, the Australian firm will be outside office hours for Tuesday and only able to agree to the call on Wednesday morning Sydney time. Although this example focuses on a specific cross-border trade, financial firms are generally "cross-time-zone" by virtue of products traded and it would be difficult to segregate trades subject to potential time-zone issues from those not. The issues raised by parties in different time zones are illustrated by the chart in Exhibit A.

Time required for call: A call for margin requires a party to calculate the amount of collateral, which will require time, especially for financial institutions managing a global book of trades. For IM (and, to a lesser extent, VM), data reconciliation prior to calculation of the margin call would facilitate the process and reduce the likelihood of dispute on the basis of differences in

portfolio. Member analysis shows that the match rate in trade portfolios increases from 88% on T+1 to 99% by T+5.

Time required for collection: The Consultation Paper envisions a range of collateral types, which as set out in Art. 1 LEC (p. 38) includes debt securities issued by Member States' and non-Member States' governments, central banks, regional governments and corporates, and equities included in a main index. The settlement cycles of these assets vary between same day (for example, cash) and T+2 (equities). If a firm envisions using non-cash collateral, it must ensure sufficient unencumbered collateral is available in anticipation of a margin call. Additionally, the settlement location of the collateral may be different from the jurisdictions and office hours of the firm meeting the margin call (for example: US Treasuries may be used to settle margin calls by a European firm to a US firm).

We recognize that use of a tri-party custodian solution may facilitate T+1 settlement of eligible assets but this solution is not optimal for all entities who may prefer bilateral agreements with third-party custodians. Imposing a shorter time period would result in a potential constraint on the products utilised due to market practice on settlement timings.

In addition, we ask that the ESAs recognize that collecting parties do not control the posting by their counterparties, so a failure by the posting counterparty should not result in sanctions on the collecting party if the collecting party has taken reasonable steps to arrange for collection.

Correction: Please note that the reference to "Section 1, Chapter 1" in Art. 1 VM (5) (p. 32) appears to be incorrect.

QUESTION 3. Model. Respondents are invited to provide comments on whether the draft RTS might produce unintended consequences concerning the design or the implementation of initial margin models. (p. 35)

A. Use of Risk Sensitivities or Classification into Asset Classes

Suggested Language:

In Art 4 MRM (3), (p. 36):

The total initial margin requirements for a netting set shall be the sum of initial margin requirements calculated separately either (a) for the risk factors assigned to each underlying asset class, or (b) for the OTC derivatives assigned to each underlying asset class within the netting set.

Explanation:

This change is needed to clarify that in order not to provide correlation offsets or diversification benefits between different asset classes, the IM calculations may be separated by risk type as an alternative to trade type. For example, if risk factors are used as described in clause (a) in the proposed text, the FX risks of a credit derivative and an equity derivative both denominated in

the same currency would both be put in the 'interest rate, currency and inflation' asset class, and could be netted against each other. We believe the intention of the ESAs is to allow this, but we think that the text of the Draft RTS is not fully clear on this point.

B. Implementation period following recalibration of 90 Days subject to extension

Suggested Language:

Art. 3 MRM (8), (p. 34):

Counterparties shall establish procedures for adjusting margin requirements in response to changing market conditions. These procedures may allow each counterparty to post the additional initial margin resulting from the recalibration of the model over a period that ranges between one and ~~thirty~~ ninety business days (or longer in times of financial stress, subject to regulatory review.)

Explanation:

The longer time period for additional IM is needed to allow firms to fund additional demands for IM. These amounts are potentially very significant, especially at times of financial stress in the markets. A 30 day limit could have procyclical effects by increasing stress on market participants during times of financial disruption. In addition, following recalibration, firms will need to adjust their infrastructure by, for example, updating the data used as input for the models. See p. 19 of our "Discussion Document"², which describes these issues. It is therefore critical that parties have at least 90 days to respond to recalibrations and that the 90 day period may be extended at times of financial stress. Moreover, the timing of any increase in IM in periods of financial stress should be subject to the discretion of regulators, acting on a coordinated global basis, who may determine that a phasing-in of an IM increase is more prudent.

C. Allow use of correlation between unsecured exposure and collateral:

Suggested language:

Art. 5 MRM (2), (p. 36):

~~Counterparties shall estimate the initial margin to be collected without taking into account any correlations between the unsecured exposure and the collateral.~~ Counterparties may include the foreign exchange risks of collateral in their initial margin model calculations so as to provide an offset between the foreign exchange risk of trades and of the margin collected against the risk of losing those trades. If a counterparty includes such foreign exchange risks in its initial margin model, then the 8% currency mismatch haircut will not apply to variation or initial margin.

² ISDA Discussion Document, 15 June 2015, submitted to the ESA JAT and posted on the ISDA website. Available at: <http://www2.isda.org/attachment/NzY2OA==/1.%20IM%20Discussion%20Paper%2020150615%20-%20CLEAN%20-%20PUBLIC.pdf>

Explanation:

The text in the Draft RTS could have adverse consequences: for example, for a euro swap collateralized by euros (in cash VM) for which IM is calculated in US dollars, this section would not recognize the offset between the collateral and the exposure. Set-off of foreign exchange risks between collateral and exposure is similar to set-off of foreign exchange risk between derivatives within the same netting set. Such set-off should be permitted in both contexts. Nothing in the BCBS-IOSCO framework for margin requirements for non-centrally cleared derivatives (the "**BCBS-IOSCO Framework**")³ prevents such an offset. Moreover, the offset is consistent with capital rules, risk management practices and the hedging process upon a counterparty default.

D. Quarterly back-testing

Suggested Language:

Art. 5 MRM (4), (p. 37):

... The performance of the model shall be monitored on a continuous basis; this analysis shall include a comparison between the risk measures generated by the model and realized risk measures ('back-testing') as prescribed by the relevant regulator every three months. ...

Explanation:

The requirements for quarterly back-testing by an entity should be determined by the applicable regulator as part of its overall supervisory responsibilities. This regulator is best placed to determine what type of back-testing is appropriate for a specific entity. The issues related to back-testing are described in the "Discussion Document"⁴, starting at p. 20.

E. Recalibration Triggers

Suggested Language:

Art. 6 MRM (6), (p. 37):

Counterparties' procedures shall describe ~~clearly identify~~ what results of the back-testing shall result in remediation ~~trigger a recalibration~~ of the model.

Explanation:

The procedures need to be flexible to cover the wide range of possible results from back-testing. Subject to pre-agreement, counterparties may take a number of measures to remediate the model they are using, ranging from the use of a margin multiplier, to designing and using a new model

³ Basel Committee on Banking Supervision ("**BCBS**") and Board of the International Organization of Securities Commissions ("**IOSCO**"), "Margin requirements for non-centrally cleared derivatives", March 2015. Available at: <http://www.bis.org/bcbs/publ/d317.pdf>

⁴ See footnote 3.

module. Recalibration may also be one of the options, but if the counterparties are using a standard industry model, their independent model recalibration may not be practicable.

F. Explanatory Note, p. 33 and Recital (6)

Suggested Language:

Recital (6), (p. 18):

~~Therefore the counterparty collecting the premium should not collect additional initial or variation margins for these type of OTC derivatives, whereas the counterparty paying the premium should collect both initial and variation margins. Therefore, if both the portfolio solely consists of bought option positions with upfront premia, and variation margin is segregated, then the option seller may choose not to collect additional initial or variation margin, whereas the option buyer should collect both initial and variation margin.~~

Section 4 – Margin Methods, “Explanatory text for consultation”, (p. 33):

~~Respondents to the first Consultation Paper noticed that the treatment of derivatives that present no counterparty credit risk for one of the two counterparties, such as short options with the premium paid in advance, was not clear. Therefore, the new Recital (6) under both the standardised method and the initial margin models, the counterparty that is not exposed to any counterparty credit risk is allowed not to include those trades in the initial margin calculations. Therefore, for bought option positions with upfront premia, and if variation margin is segregated, then the option seller may choose not to collect additional initial or variation margin, whereas the option buyer should collect both initial and variation margin.~~

Explanation:

The text suggests there is no counterparty credit risk if the counterparty has bought an option and paid for it upfront. But the text also states that the counterparty should collect IM and VM, which in practice will mean the immediate return of the premium as VM (as the exposure value equals the premium). The option seller now has counterparty risk again unless the IM and VM have been segregated. If the VM is not segregated, and the value of the option decreases (through changes in either spot or volatility), then the option seller has counterparty credit exposure because of the VM.

It is not correct that a sold option position (in the presence of unsegregated VM) has no counterparty credit risk. It has counterparty credit risk in the same way as all other derivatives. Once VM is exchanged, the net value of the option plus the VM is approximately zero. And this value can go up due to market movement, which creates counterparty credit exposure (unless all the relevant margin is segregated.)

G. The model should incorporate interest rate risk factors corresponding to all foreign currencies.

Suggested Language:

Art. 5 MRM (3)(b), (p. 36):

(b) the model shall incorporate interest rate risk factors corresponding to the individual ~~foreign~~ currencies in which the OTC derivative contracts are denominated;

Explanation:

It is not clear what is meant by "foreign currencies" in this context and the model should address interest rate risk factors for all currencies.

QUESTION 4. Concentration. Respondents are invited to comment on whether the requirements of this section [eligibility and treatment of collateral] concerning the concentration limits address the concerns expressed on the previous proposal. (p. 43)

A. Collateral threshold of EUR 1 billion is to be calculated on a bilateral, non-consolidated basis

Suggested Language:

Art. 7 LEC (2), (p. 43):

The risk management procedures shall provide that the collateral collected from an individual counterparty pursuant to this regulation in excess of EUR 1 billion shall meet the conditions in paragraph 4 where each of the counterparties belong to one of the categories listed in paragraph 3.

Art. 7, LEC (3)(c), (p. 44):

(c) counterparties, for which the total amount of initial margin to be collected by the counterparty itself ~~(and not $\text{\textcircled{e}}$ from counterparties belonging to its group)~~ from an individual counterparty exceeds EUR 1 billion.

Explanation:

These changes clarify that the EUR 1 billion threshold is calculated on a bilateral, non-consolidated basis. The ESAs issued slides following a public hearing on 18 June 2015 on the Consultation Paper and Slide 17 specifically provides that the EUR 1 billion threshold applies to collections "in a single netting set". A netting set for purposes of the RTS is a "group of

transactions between an institution and a single counterparty ..."⁵ and therefore the EUR 1 billion should be determined based solely on OTC derivatives between two individual counterparties.

B. De minimis: no concentration limits for counterparties exempt from IM

Suggested Language:

The following paragraph should be added to the end of Art. 7 LEC:

5. Paragraphs 1 and 2 above do not apply to a counterparty that is not subject to initial margin requirements.

Explanation:

Concentration limits should not apply to parties that have small amounts of margin. As the first Consultation Paper (14 April 2014) pointed out (p. 38), if concentration limits apply to small amounts of margin, the posting party would need to diversify into multiple smaller lots which could pose significant operational burdens relative to the size of the collateral and exposure. In addition, the liquidity considerations that concentration limits are designed to mitigate are not applicable to small portfolios because the liquidation of small amounts of margin should not have a significant impact on the market.

For these reasons, we propose that the concentration limits will not apply to a counterparty that is not subject to the IM requirements. This approach appropriately imposes the concentration limits on systemically important parties but not on others. It uses an existing threshold so that it imposes less of an administrative burden on the parties and regulators. It also minimizes a "cliff" issue which could arise with a threshold tied to a fixed amount of collateral: if such a fixed threshold is breached, the concentration limits might immediately apply to all previously posted collateral.

C. Identification of G-SIIs and O-SIIs

Suggested Language:

Art. 7 LEC (3), (pp. 43-44): Add at the end:

EBA shall publish and maintain a list of G-SIIs and O-SIIs on its website for purposes of this section.

Explanation:

The ESAs should publish a list of G-SIIs and O-SIIs so that parties can readily make a determination about the applicability of concentration limits. Parties will need to be able to rely on the latest version of such list. We note that the list of large institutions currently on the EBA

⁵ Article 272(4) of Regulation (EU) 575/2013, which provides the definition of "netting set" for the Draft RTS under Art. 8 GEN, (2)(e) (p. 30).

website⁶ does not appear to be a list of institutions which have been identified by their member state authority as a G-SII.

Article 131(12) of the CRD IV requires competent authorities to provide the names of the G-SIIs and O-SIIs identified by them to the European Commission (the "**Commission**"), the European Systemic Risk Board and EBA and to disclose their names to the public.⁷ However, there is no centralized list available to market participants.⁸

D. Correction to Art. 7 LEC (4)(a)

Suggested Language: Art. 7 LEC (4)(a), (p. 44):

(a) the sum of the values of the securities from the asset classes (c), (d), (e) [Sovereign, regional auth. and PSEs], (h), (i), (m) [multilateral development banks, International Organisations, credit institutions ~~non-Member States' regional governments, local authorities not meeting the requirements~~], (j) and (k) [non-EU Sovereign, regional auth. and PSEs] in Article 1 LEC ...

Explanation:

This appears to be a drafting error.

E. Close Links

Suggested Language:

Art. 6 LEC 1(b), (p. 42):

1. The risk management procedures required for compliance with paragraph 3 of Article 11 of Regulation (EU) No 648/2012, shall ensure that securities referred to in points (f), (g) and (k) to (r) of Article 1 LEC fulfill all of the following criteria:

(a) they are not issued by the posting counterparty;

(b) they are not issued by entities which are part of the same group, as defined in Article 2(16) of Regulation 648/2012, as that of the posting counterparty, ~~nor by entities which have close links with the posting counterparty, as defined in Article 2 (24) of Regulation (EU) No 648/2012;~~

Art. 7 LEC (1)(a), (p. 43):

(a) the sum of the values of the securities from the asset classes (b) [gold], (f), (g), (l) [non-EU PSE and regional auth. not meeting conditions] and (n) to (r) referred to in Article 1 LEC] issued

⁶ <https://www.eba.europa.eu/risk-analysis-and-data/global-systemically-important-institutions>

⁷ Directive 2013/36/EU.

⁸ The proposed wording of this provision is based on the wording of Article 5(3) of MiFID2 relating to ESMA's duty to publish a list of investment firms.

by a single issuer or by entities which are part of the same group, as defined in Article 2(16) of Regulation 648/2012 ~~or entities which have close links, according to Article 2 (24) of Regulation (EU) No 648/2012~~ shall not exceed 10% of the collateral collected from that individual counterparty;

Explanation:

The concept of "close links", which can mean as little as 20% common ownership, is used in both the concentration limits and the wrong way risk section of the Draft RTS. It is extremely difficult for parties to know who has 20% stakes in the issuers of the relevant collateral. In addition, a 20% stake will not necessarily be an indication of a relationship that justifies including the owner in a concentration limit or wrong way risk test. We propose deleting the "close links" test.

F. Exemption for Equity Collateral for Related Derivatives:

Suggested Language:

Art. 7 LEC (5), (p. 44): Add a new paragraph 5:

5. If equity derivatives are secured by the equities underlying the derivatives, then those equities are not subject to (a) the concentration limits in this Article 7 LEC and (b) the eligibility requirement in Article 1 LEC 1(q) that equity must be included in a main index.

Explanation:

The risks in equity derivatives are often best mitigated by margin in the form of the relevant underlying equity. A buyer of a call option on particular shares, for example, can mitigate its risks if it collects those shares as collateral from the buyer. If the concentration or eligibility limits prevent the use of this type of collateral, such limits will increase risk rather than reduce it.

G. Minimum Threshold of EUR 10 million for 10% Collateral

Suggested Language:

Art. 7 LEC (1)(a), (p. 43):

(a) the sum of the values of the securities from the asset classes (b) [gold], (f), (g), (l) [non-EU PSE and regional auth. not meeting conditions] and (n) to (r) referred to in Article 1 LEC] issued by a single issuer or by entities which are part of the same group, as defined in Article 2(16) of Regulation 648/2012 or entities which have close links, according to Article 2 (24) of Regulation (EU) No 648/2012 shall not exceed the greater of (a) 10% of the collateral collected from that individual counterparty and (b) EUR 10 million;

Explanation:

The 10% concentration limit may result in required transfers of small amounts of collateral. In order to avoid a requirement for non-material transfers, we propose that the amount of collateral must be greater than EUR 10 million before concentration limits are exceeded.

QUESTION 5. Trading Relationship Documentation. Respondents to this consultation are invited to highlight their concerns on the requirements on trading relationship documentation. (p. 47)

Suggested language:

Art. 2 OPD (2), (p. 48):

- (2) To the extent that a counterparty relies on close-out netting as part of a collateral arrangement, it ~~A counterparty shall perform an independent legal review at least on an annual basis in order to verify the legal enforceability of the bilateral netting arrangements (and always be able to provide documentation evidencing that review) supporting the legal basis for compliance of the arrangements in each jurisdiction in order to establish in each relevant jurisdiction that the contractual close-out netting agreement creates a single legally enforceable net obligation (which takes into account the value of the collateral) in the event of a default of the other party.~~
- (3) To the extent that a counterparty is already subject to a requirement to obtain and review close-out netting opinions under the prudential regulatory regime applicable to it, then satisfying such requirements will also satisfy the legal review requirements under this Art 2 OPD (2).

Explanation:

We would suggest Article 2 OPD (2) be more closely aligned with the requirements of Article 296 of Regulation (EU) No 575/2013. In particular, the requirement for the independent legal review to be carried out each year is still potentially cumbersome. Multiple jurisdictions will be relevant for each counterparty and in a single jurisdiction there may be a number of different insolvency and netting regimes to consider depending on the particular counterparty type. The legal review will be complex and in many cases parties will need to instruct external counsel in order to satisfy the requirement that they have performed an independent legal review. Imposing an annual requirement will therefore be impractical, costly and operationally onerous.

Furthermore, whilst regulated institutions are already subject to close-out netting opinion requirements and are likely to source many of the relevant opinions from industry bodies, the requirements are even more burdensome from the perspective of financial counterparties which are not subject to prudential requirements and unregulated non-financial counterparties within the scope of the Draft RTS. An entity that was not previously required to obtain close-out netting opinions will not necessarily have access to industry opinions or systems and internal capacity to obtain and review close-out netting opinions annually.

Consequently, we would suggest deleting the requirement to carry out the review on at least an annual basis, consistent with the position under Article 296 of Regulation (EU) No 575/2013.

We would also suggest that to avoid creating overlapping requirements, satisfaction of the netting opinion requirements applicable under an entity's regulatory regime is deemed to satisfy the legal review requirement in Article 2 OPD (2).

In addition, we welcome the removal of the requirement to obtain a written agreement with all counterparties, including NFC-s. This will reduce the unnecessary documentation and operation burden on banks dealing uncleared OTC derivatives with corporates. Counterparties can focus on their preparation and compliance efforts on transactions that are in scope of the BCBS-IOSCO Framework, i.e. uncleared OTC derivatives with and between financial counterparties and non-financial counterparties over the clearing threshold.

QUESTION 6. Compliance Requirements. Respondents are invited to comment on the requirements of this section [operational procedures and documentation] concerning the legal basis for the compliance. (p. 48)

Suggested Language:

Article 1 SEG, (p. 48)

1. Collateral collected as initial margin shall be segregated from proprietary assets of the collecting counterparty on the books and records of a third party holder or custodian, or via other legally binding arrangements made by the collecting counterparty to protect the initial margin from the default or insolvency of the collecting counterparty. Such requirements to segregate the collateral from the proprietary assets of the collecting counterparty will also be satisfied where the collateral is held in an account in the name of the posting counterparty which is secured in favour of the collecting counterparty. The arrangements will also protect collateral other than cash from the default or insolvency of the ~~the~~ third party holder or custodian.
2. Where the collateral is held by the collecting party or by a third party holder or custodian on behalf of the collecting party, ~~t~~The collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties ('individual segregation').
- ~~3. Where initial margin is collected in cash it shall be segregated individually, unless the collecting counterparty has legally binding arrangements in place to segregate it from proprietary assets.~~
- 4 ~~3~~. The segregation arrangements shall ensure that the initial margins are available to the posting counterparty in a timely manner in case the other counterparty defaults.

54 . A counterparty shall perform an independent legal review ~~at least on an annual basis~~ in order to verify that the segregation arrangements meet the requirements referred to in paragraphs 3 and 4 and always be able to provide documentation supporting the legal basis for compliance of the arrangements in each jurisdiction.

Art. 2 LEC (1)(d), (p. 39):

(d) cash accounts in all the acceptable currencies are maintained with a party other than the collateral provider for depositing cash collateral collected as initial margin and for crediting the proceeds of repurchase agreements on the collateral (and such cash accounts may include accounts maintained by a custodian in the name of the collateral provider);

Art. 2 LEC (1)(g), (p. 40):

(g) the collateral shall be transferable without any regulatory or legal constraints or third party claims, including those of the liquidator of the collecting counterparty or third party custodian (other than liens for fees and expenses incurred in providing the custodial accounts);

Explanation:

A. Cash should be eligible as IM if protected from insolvency of collecting party

Article 1 SEG (1) requires that IM is protected from the default or insolvency of the third party holder or custodian. It is not possible to achieve this in respect of cash as the return of the cash is inherently linked to the solvency of the third party holder or custodian acting as banker. We understand from the EBA public hearing that the ESAs are aware of this and as a consequence the ESAs expect that cash will only be permissible as IM if it is reinvested under Article 1 REU (2).

As proposed, the Draft RTS requirement that cash be protected from the default or insolvency of the third party holder has the effect of prohibiting cash from being posted as eligible IM. We note that cash is the first asset listed in key principle 4 of the BCBS-IOSCO Framework and the background discussion describes cash as one of the most liquid top-quality assets. Cash provides vital liquidity if securities are not available for posting. Cash can also be quickly and easily transferred to remedy collateral deficits or as a substitute for other assets that the posting party needs returned.

The margining requirements are designed to remove counterparty credit risk (rather than custodial risk) in line with the G-20 mandate. Key principle 5 of the BCBS-IOSCO Framework requires that IM should be held in such a way as to protect the posting party from the collecting party's bankruptcy and vice versa.⁹ Protecting the posting party from the default of the collecting party may be achieved by segregating cash IM from the proprietary assets of the collecting party. Neither the G-20 mandate nor the BCBS-IOSCO Framework envisage protecting margin from custodian related risk even though the BCBS-IOSCO Framework specifically envisages the use of third party custodians as a method to protect IM. Consequently this should not be introduced as a requirement now, particularly if it has the effect of limiting the ability to post cash as IM.

⁹ BCBS-IOSCO Framework, p. 20.

Cash will always ultimately be held by a custodian as banker and, therefore, subject to custodian credit risk. This risk should not be addressed by the margin segregation rules as custodian credit risk is not the focus of the G-20 mandate or the BCBS-IOSCO Framework and requiring protection from custodian credit risk limits the ability to post cash as IM. Rather, custodian credit risk should be addressed by the bank and other supervisory rules applicable to custodians.

Possible custodian credit risk mitigants

If the ESAs are of the view that custodian default risk in respect of cash must be mitigated, there are other risk mitigants available (in addition to any cash reinvestment option) which would still allow cash to be posted as eligible IM. If the ESAs include example mitigants in the RTS, we would advocate that such mitigants are included on a non-exhaustive basis to enable parties to mitigate custodian default risk in the manner parties deem most appropriate. For example:

- (a) a credit quality assessment requirement on the custodian; or
- (b) the custodian is not an affiliate of the collecting party or the posting party (which would have synergies with the US requirements).

B. Types of IM arrangements and suggested clarifications to Article 1 SEG (2) and (3) and Art 2 LEC (1)(d)

Explanation:

Our members have focussed on two IM structures which are: (a) the ‘direct’ model and (b) the ‘alternative model’, both as described below.

Under the direct model, the IM is held in the name of the collecting party. The IM is usually held in an account at a third party holder or custodian acting on behalf of the collecting party (although in respect of securities this is not necessary for compliance with the Draft RTS). However, we expect that in many (or even the majority of) cases, the IM will not be provided under the direct model. Instead the IM will be provided under the alternative model.

Under the alternative model, the IM securities will remain with the posting party and legal title will never pass to the collecting party prior to foreclosure/enforcement. The IM cash will also be held in an account in the name of the posting party that is charged in favour of the collecting party (see also discussion in relation to cash collateral above).

Article 1 SEG and Article 2 LEC (1)(d) of the Draft RTS appear to have been drafted primarily with the ‘direct’ model in mind. We suggest the changes proposed above so that these provisions are also suitable for the ‘alternative model’.

C. Custodial liens

Explanation:

In both the direct model and the alternative model, a third party custodian or holder is likely to be involved in the arrangement (as described above). Such custodians will need to be

incentivised to offer services in relation to IM arrangements and will charge fees for their services. A custodian would normally be secured in respect of such fees by a custodial lien. Article 2 LEC (1)(g) (p. 40) and the Recitals should therefore permit custodial or third party liens and security interests to the extent the lien or security interest is limited to the fees and expenses incurred in providing the custodial accounts. If all such liens or security interests are prohibited, there may be reluctance on the part of the custodians to provide the necessary custodial services to facilitate the posting of IM.

D. Independent Legal Review

Explanation:

The removal of the requirement for a formal legal opinion on the segregation arrangements is welcomed. However, whilst we recognise the need for arrangements to be appropriately diligenced, the requirement for the independent legal review to be carried out each year is still potentially cumbersome for the reasons set out above in respect of the annual legal review requirement in Article 2 OPD (2). Furthermore, the legal review in Article 1 SEG covers complex areas of law not previously covered by industry opinions. To demonstrate the scale of the task, ISDA has commissioned netting opinions in respect of 59 jurisdictions and collateral opinions in respect of 52 jurisdictions and parties may also be transacting with entities not covered by industry opinions. As the opinions relate to new legal requirements, concerns around the time it will take to obtain the relevant opinions, the novelty of the subject matter and the cost arise not just for entities not previously subject to prudential opinion requirements but for all entities entering into OTC derivatives within the scope of the RTS.

Consequently, as with Article 2 OPD (2), we would suggest deleting the requirement to carry out the review on at least an annual basis.

If the requirement to segregate cash individually in Article 1 SEG (3) is retained, we would also suggest that the scope of the independent legal review is limited to the requirement in paragraph 4 of Article 1 SEG that the collateral is available to the posting party in a timely manner upon counterparty default. In order to reach the conclusion that the collateral is so available, the analysis will need to conclude that segregation or other legally binding arrangements are effective to prevent the assets falling into the insolvent estate of the collecting party. It is not clear why an additional opinion on whether cash has been ‘individually segregated’ is of additional comfort to the parties or the regulators.

QUESTION 7. Does this approach [with regard to re-investment of cash] address the concerns on the use of cash for initial margin? (p. 49)

Suggested Language:

Article 1 REU, (p. 48, 49):

1. The collecting counterparty shall not re-hypothecate, re-pledge nor otherwise re-use the collateral collected as initial margin.

2. Initial margin posted in cash can be (a) held in cash if segregated from the proprietary assets of the collecting party or (b) re-invested by the collecting counterparty or the custodian only for the purpose of protecting the collateral poster (or re-invested by a custodian holding initial margin on behalf of the posting party), and subject to an agreement between the counterparties. The re-invested collateral shall be treated in accordance with Articles 1 LEC and 1 SEG [segregation and eligibility].

Explanation:

A. Issues with the reinvestment solution

As discussed above, the collecting party should be able to hold IM in cash. If cash is properly segregated from the proprietary assets of the collecting party, the use of cash will not expose the counterparty to credit risk of the collecting party. Moreover, the reinvestment requirements in Article 1 REU (2) (p. 49) raise practical/commercial issues so that some parties may prefer to use cash IM without reinvesting it. Reinvestment involves a degree of complexity that goes beyond what some simple custody arrangements currently provide. For example, the collecting party and the posting party may have difficulties in agreeing on the reinvestment strategy and who will be responsible for monitoring the performance of the strategy. In addition, reinvestment via a third party will add to the complexity of monitoring concentration, correlation and other limits on a counterparty by counterparty basis, particularly if any discretion is given to the custodian (e.g. setting a pool of eligible collateral). If the reinvested asset is subject to the haircuts that would normally apply if it was posted directly (as opposed to still treating the reinvested asset as cash), reinvestment may also potentially result in a further margin call being required.

It is also not clear whether the ESAs intend for Article 1 REU (2) to apply where the collateral is held in an account at a third party custodian in the name of the posting party which is charged in favour of the collecting party (see further the description of the ‘alternative model’ above). The explanatory text suggests that Article 1 REU (2) is primarily intended to protect against collecting party default – there is no such risk in the case where the collateral is held in an account in the name of the posting party.

B. Even if cash is not normally eligible without reinvestment, some cash will always be present

Even if the ESAs do retain the prohibition on the posting party taking credit risk on the custodian for return of cash (which we believe is not the correct outcome for the reasons specified above), there needs to be an exception for the residual level of cash that will be in the structure from time to time (e.g. distributions, redemption proceeds or cash generated by the reinvestment strategy). As a result, the final rules would need to include a grace period during which it is acceptable for the posting party to be exposed to custodian credit risk for the return of cash. During this grace period the parties would either seek to substitute the cash out of the arrangement or reinvest it. We would suggest a 3 business day grace period.

QUESTION 8. Respondents are invited to comment on the requirements of this section [standard haircut to market value of collateral] concerning treatment of FX mismatch between collateral and OTC derivatives. (p. 57)

A. Clarification for treatment of cash margin

Suggested Language:

Annex II (6) and (7) (pp. 57, 58):

6. Where the agreement between the two counterparties includes a termination currency, the counterparties shall apply a haircut of 8% to the market value of the non-cash assets where the collateral posted as initial margin is denominated in a currency other than the termination currency. Where the agreement does not identify a termination currency, the haircut will apply to the market value of all the non-cash assets posted as collateral for initial margin. Parties may specify different termination currencies for each party.

7. Where the agreement between the two counterparties includes a transfer currency, the counterparties shall apply a haircut of 8% to the market value of the non-cash assets posted as collateral for the unsettled variation margin where the collateral is denominated in a currency other than the transfer currency of the variation margin. Where the agreement does not identify a transfer currency, the haircut will apply to the market value of all the non-cash assets posted as collateral for the unsettled variation margin. Parties may specify different transfer currencies for each party.

Explanation:

The language clarifies that cash collateral is not subject to the 8% haircut. This is consistent with Recital (11) (p. 19) and Annex II (5) (p. 57) which indicate that cash collateral is not subject to any haircut.

In addition, the proposed language makes it clear that each party can specify its own termination currency and transfer currency. This is important because there are funding challenges if firms are forced to post in a termination or transfer currency which does not match what is available to them.

For example, for a Japanese entity posting IM in Japanese government bonds ("**JGBs**"), the termination and transfer currency should be Japanese yen ("**JPY**") rather than US dollars ("**USD**"), which is likely to be the default termination and transfer currency for US-based dealers. In this scenario, the Japanese entity would post JGBs and the US entity would post US Treasury securities ("**USTs**"). If the agreement specifies USD as the termination/transfer currency, then the US entity would not be able to accept JGBs without imposing the additional 8% haircut on the collateral posted by the Japanese entity, and the Japanese entity would have higher funding costs if it delivered USTs.

To avoid this, our proposal would be to permit parties to designate a termination and transfer currency for each party that can match the collateral they are expecting to post. Continuing our example, we would designate the termination currency and the transfer currency as JPY where

the termination amount (before applying any IM) was payable by the Japanese entity to the US entity, and USD where it was payable by the US entity to Japanese entity.

The definition in a Master Agreement may allow firms flexibility in the termination currency: for example, many existing Master Agreements provide that the termination currency is a currency to be specified from a defined range after an event of default. We want firms to have the same flexibility in relation to the respective termination currencies they may identify from time to time for purposes of the 8% haircut. Alternatively, it will be necessary for each party in a pair to designate as its respective termination currency for IM purposes a single currency from the range which they would be permitted to designate as a termination currency under the Master Agreement.

II. ISSUES NOT RAISED IN QUESTIONS IN CONSULTATION PAPER

ISSUE 1. Cross-Border.

A. Permit transactions with non-netting jurisdictions for up to 5% of an entity's OTC derivatives.

Suggestion:

We ask the ESAs to provide an exemption from the margin requirements for an entity's OTC derivatives with parties in "non-netting jurisdictions" for up to 5% of the entity's OTC derivatives (measured by notional amounts). "**Non-Netting Jurisdictions**" are those in which it is not possible to get a clean netting opinion.

Explanation:

For Non-Netting Jurisdictions, market participants typically do not employ collateral as a risk mitigant. Without enforceable netting there is the risk that the administrator of an insolvent counterparty will "cherry-pick" from posted collateral to be returned in the event of insolvency, which will result in an increase in the risk in posting collateral. In the context of segregation, the Consultation Paper suggests (Recital 8) that "counterparties should identify alternative processes ... such as relying on third party banks or custodians domiciled in jurisdictions where [the requirements of the RTS] can be guaranteed." However, a party in a Non-Netting Jurisdiction (a "**Non-Netting Party**") may be subject to local insolvency proceedings and such proceedings may affect the treatment of margin posted by or held (directly or indirectly) by the Non-Netting Party. Use of a third-party custodian in a different jurisdiction may not remedy issues with the legal enforceability of collateral.

Imposing the margin requirements on OTC derivatives with Non-Netting Parties will severely limit such OTC derivatives. Such a limitation will cause significant disruptions in financial markets and prevent hedging and financial flows between the EU and Non-Netting Jurisdictions. Moreover, requiring collateral posting may prevent parties from using more effective alternative

mitigations such as using limits to contain exposures, re-pricing trades, selling options and using short dated trades.

In addition, while these OTC derivatives are important for individual Non-Netting Parties and Non-Netting Jurisdictions, the overall volume of such OTC derivatives is relatively small compared to the total volume of OTC derivatives entered into by EU counterparties. (See discussions and charts in Exhibits B and C.) By limiting the total volume of such exempt OTC derivatives to 5% of the entity's OTC derivatives, the ESAs will limit the systemic impact of the exemption.

EMIR Text. Article 11(3) and Article 11(15) of EMIR allow the ESAs and the Commission flexibility in setting the scope of the mandatory margin requirements. Art. 11(3) is not expressed in terms that require an FC or NFC+ to require an exchange of margin with respect to all their relevant contracts. Art. 11(3) requires FCs and NFC+s to have procedures for the exchange of collateral for the portfolio of contracts covered by Art. 11(3) but that does not mean that those procedures require margin to be collected for each and every contract. We believe the ESAs have recognized this flexibility by exempting OTC derivatives with non-EU NFC-s from the margin requirements. We ask that the ESAs use this flexibility in connection with derivatives with Non-Netting Parties.

US Regulatory Precedent. In addition, we note that there is precedent in the US for a 5% exemption similar to the one described above. In its cross-border guidance, the Commodity Futures Trading Commission (the "CFTC") exempted swaps from US transaction-level requirements if the swaps are between a non-US branch of a US swap dealer and a non-US counterparty (located outside Australia, Canada, the EU, Hong Kong, Japan or Switzerland) if the aggregate notional value of such swaps is less than 5% of the total and if the US dealer maintains records and addresses the risks that may arise from the non-application of the US transactional requirements.¹⁰

B. Transitional Equivalency Determination for Jurisdictions Following BCBS-IOSCO

Suggestion:

The ESAs should make a temporary equivalency determination, valid for two years, for other jurisdictions that adopt margin requirements based on the BCBS-IOSCO Framework. This determination should be made as soon as other jurisdictions issue final rules.

Explanation:

The prior draft of the RTS did not require EU parties to post collateral to non-EU parties. Because such posting is required in the current Draft RTS, there is a potential conflict with rules of other countries that require the collection of margin. It is therefore critical that equivalency

¹⁰ CFTC, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 at 45351. See also the CFTC Clearing Exemption, 78 FR 21750 at 21784 (Sec. 50.52(b)(4)(iii)) for another 5% exemption from certain requirements for swaps located outside the US, EU, Japan and Singapore.

determinations be made as soon as possible after the relevant margin rules are adopted, and before the compliance date of the Draft RTS.

Regulators from multiple jurisdictions have developed a framework for consistent margin rules, as set out in the BCBS-IOSCO Framework, through an extensive consultative process. The US and Japanese regulators have proposed margin requirements based on the BCBS-IOSCO Framework. Other jurisdictions may issue similar rules in the near future. Because these rules have already been considered and debated during the lengthy BCBS-IOSCO process, an equivalency determination should be significantly easier than for rules developed independently by different regulators. Given the volume of OTC derivatives between market participants in the EU, US and Japan, it is critical that such an equivalency determination be made as soon as possible so that parties can make appropriate arrangements before the compliance dates.

C. Transitional exemption for OTC Derivatives with parties in jurisdictions with no margin requirements

Suggestion:

The ESAs should provide a two year exemption for transactions between EU parties and counterparties in jurisdictions without margin requirements.

Explanation:

The margin requirements will be very difficult to implement for counterparties in jurisdictions without margin rules: such parties will not have familiarity with the rules and do not have the same regulatory incentives to take the needed operational and documentation measures. Market participants in the EU can educate counterparties but such education and the subsequent implementation will take time. Without a phase-in, many counterparties in jurisdictions without margin rules will not be able to post or collect margin by the compliance dates and will therefore be unable to trade with counterparties in the EU.

ISSUE 2. Intragroup Transactions.

A. General exemption for IM for intragroup transactions

Suggestion:

The ESAs should provide for a general exemption for intragroup transactions from IM requirements.

Explanation:

Intragroup transactions simply do not raise the same systemic and counterparty risk issues that are raised by derivatives with third parties. The financial health of any group member is very closely linked to that of other group members, and as a result the critical issue for mitigating systemic and counterparty risk is protection against potential exposure to the group overall. The

Draft RTS implicitly recognize that corporate groups, rather than individual corporate entities, should be the focus of risk analysis for IM because the thresholds are determined based on group exposure rather than on the exposure of individual entities.

In addition, in the absence of a general exemption for IM, it is not clear how the thresholds will apply to intragroup transactions. The thresholds must be applied at a group level. It is not possible to calculate the thresholds at a group level where the parties to the transaction are members of the same group.

This exemption from IM should be available even where the conditions specified under Art. 3 and Art. 11(5) to (10) of EMIR have not been met. Imposing a requirement for VM should be sufficient mitigation of risk on intragroup transactions where those conditions are not satisfied.

B. Transitional Exemption for Cross-Border Intragroup Transactions

Suggested Language: Add a new section:

This Regulation shall not require a financial counterparty or a non-financial counterparty referred to in Art. 10 of Regulation (EU) No 648/2012 to have the risk management procedures described in this Regulation with respect to OTC-derivative contracts with an entity established in a third country which is a member of its group until the earlier of 1 December 2018 or one year after an implementing act adopted by the Commission under Art. 13(2) in respect of that third country has come into force."

Explanation:

Under EMIR, intragroup transactions only benefit from the exemption from Art. 11(3) where the conditions in Art. 3 and Art. 11(5) to (10) are met. ESMA's questions and answers on the implementation of EMIR make clear that the intragroup exemption is not available for transactions between an FC or NFC+ and a counterparty established in a non-EU country unless and until the Commission has adopted an implementing act on equivalence in relation to that non-EU jurisdiction under Art. 13(2) of EMIR.

There have been considerable delays in finalizing the equivalence assessments under Art. 13(2) of EMIR even in relation to the initial group of non-EU countries on which ESMA has already delivered technical advice to the Commission. It is also clear that it will be some time before such an equivalence assessment can be adopted by the Commission for many countries as this will be dependent on their rate of progress in implementing the G20 derivatives agenda. In any event, FCs and NFC+s engage in derivatives transactions with group companies in a very large number of non-EU countries and there are limited resources at ESMA and the Commission to address all of these in the limited period of time available before the margin rules become effective. We understand that the Commission is developing a mechanism to address this issue in the context of the intragroup exemption from the clearing obligation so as to provide in effect a transitional period.

In addition, it is currently unclear whether equivalence assessments under Art. 13(2) of EMIR will include provisions for partial or conditional determinations of equivalence as envisaged by

ESMA's advice and whether or how any such determinations will affect the intragroup exemption. Counterparties will need additional time to adjust to any additional requirements imposed as a result.

ISDA is therefore very concerned that only intragroup transactions between group entities located within the boundaries of the EU will qualify for the definition of intragroup transactions by the time these standards are being applied, as no such implementing acts will have been adopted.

Unless consideration is given to the timing of adoption and application of different EMIR technical standards in this context, this would be a major concern for international financial, non-financial and mixed groups who wish to be able to continue both to invest in Europe and to prudently manage related business risks. Requiring the clearing and margining of such transactions executed within groups (and not with external counterparties) is not only unjustified in counterparty risk terms, but may actually be damaging in terms of creating new counterparty and operational risk (because so many group entities would be forced to deal with clearing houses, for example) and a disincentive to such investment and hedging decisions. Put simply, it provides another reason for such groups not to invest in Europe (note that our concern here goes beyond 'US'-headquartered groups and focuses also on groups from other, fast-growing jurisdictions).

ISSUE 3. Exemption for trades required by regulation

Suggestion:

The margin requirements should not apply to legacy OTC derivatives that are transferred to an EU entity if such transfer is required to comply with bank regulations.

Explanation:

Bank structural reform regulations, such as the UK Banking Reform Act or the EU Bank Structural Reform regulation, may require transfers of legacy uncleared OTC derivatives between different EU entities. Imposing margin requirements on such entities would increase the burden of complying with EU member state requirements, although such arrangements are intended to reduce incremental systemic risk (as opposed to increasing it). This may also cause a group to exceed any IM phase-in threshold when that group is merely complying with its wider EU obligations.

ISSUE 4. Eligible collateral limited to collateral that can be liquidated in a timely manner

Suggested Language:

Art. 1 LEC, (p. 38)

~~For the purposes of Article 11(3) of Regulation (EU) No 648/2012, asset classes for which the counterparty has no access to the market or is unable to liquidate the collateral in a timely manner in case of default of the posting counterparty shall not be eligible.~~ A counterparty shall only collect collateral for the purposes of Article 11(3) of Regulation (EU) No 648/2012, from the asset classes listed below ...

Explanation:

It will not always be possible to know whether a party has the ability to liquidate the collateral in a timely manner. At times of significant financial stress, many forms of collateral may become difficult to liquidate. In addition, it may not be possible for one party to know whether the other party is able to liquidate certain types of collateral, which may make it difficult for the parties to agree on acceptable collateral.

ISSUE 5. Use of standardised IM method if IM model does not cover all OTC derivatives in a netting set

Suggestion:

The ESAs should clarify that parties that use an IM model for OTC derivatives may use the standardised method for specific OTC derivatives within the same netting set if the model does not appropriately calculate the IM for those derivatives.

Explanation:

Parties using an IM model for a netting set may find that the model cannot address a specific OTC derivative within the netting set. The parties may therefore use the standardized method for that specific derivative. In a dispute, counterparties using an IM model may also use the standardized method for a particular trade to resolve the dispute. There is no reason that the trade using the standardized method should be excluded from the netting set used for other trades: the definition of netting set relies on the existence of a legally enforceable netting arrangement.¹¹ The application of the standardized method would not prevent an OTC derivative from qualifying for an enforceable netting arrangement.

The BCBS-IOSCO Framework states that a "firm need not restrict itself to a model-based approach or to a schedule-based approach ..."¹² While the BCBS-IOSCO Framework makes it

¹¹ Article 272(4) of Regulation (EU) 575/2013

¹² BCBS-IOSCO Framework, Sec. 3.9, p. 14.

clear that firms should not be able to change methodologies to "cherry pick" the most favorable IM terms, our proposal does not permit such cherry picking. We are asking to use the standardized model when the IM model cannot appropriately calculate the IM.

ISSUE 6. Corrections

A. Calculation of EUR 8 billion threshold.

The ESAs should make it clear whether the calculation of the EUR 8 billion threshold is based on notional amounts in March, April and May or in June July and August. Art. 7 GEN (1) provides that the EUR 8 billion threshold is determined in June, July and August, while Art. 1 FP (4)(a) provides that it is determined in March, April and May.

B. Art. 1 GEN (6), (p.27):

The text should be changed as follows: " ... Articles 1 HC and 2 HC of ~~that~~ Section 6."

* * *

ISDA appreciates the opportunity to provide this letter to the ESAs. We would welcome the opportunity to assist the ESAs in their efforts to revise the Draft RTS and implement the rules therein. Please feel free to contact us at your convenience.

Sincerely,



Scott O'Malia
Chief Executive Officer
ISDA

EXHIBIT B

Volumes of OTC Derivatives with Non-Netting Jurisdictions

For purposes of establishing volumes of OTC derivatives with counterparties in non-netting jurisdictions, we provide the following quotation from a 16 January 2015 letter to US regulators.

ISDA member firms were asked to provide the total gross notional amount for their uncleared derivatives for all jurisdictions (netting and non-netting).¹³ For all non-netting jurisdictions, they were asked to provide the name of the jurisdiction and the total gross notional amount of uncleared derivatives with counterparties in that jurisdiction. A complete list of the provided jurisdictions and total gross notional percentages can be found in Exhibit C.

Below is a summary, by institution, of the % of total outstanding notional with non-netting jurisdictions and the maximum gross notional % traded with counterparties in a single non-netting jurisdiction. As we observed, only a small percentage of the total outstanding gross notional for uncleared derivatives is concentrated in non-netting jurisdictions, however, there are instances where this concentration may exceed 5% for a given covered swap entity.¹⁴

	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
% of total outstanding notional with non-netting jurisdictions	0.2711%	0.4091%	0.5326%	0.5117%	0.3042%	0.4099%	5.4160%	2.6963%	0.5247%
Maximum gross notional % to a single non-netting jurisdiction	0.1346%	0.1311%	0.4199%	0.2619%	0.1056%	0.2011%	2.2356%	1.7083%	0.1893%

¹³ For purposes of these charts, non-netting jurisdictions are assumed to be those other than the "clean netting jurisdictions" as determined by ISDA opinions. The list of clean netting jurisdictions may be found at http://www.isda.org/docproj/stat_of_net_opin.html. Note that this is not designed to be an exhaustive list of netting and non-netting jurisdictions and has been compiled for ease of reference. Parties are always free to obtain additional opinions or seek alternative advice.

¹⁴ We reiterate our request that covered swap entities not be required to post margin (initial margin or variation margin) to counterparties in jurisdictions lacking enforceable netting. As noted in our original response letter to the US Prudential Regulators, without enforceable netting, there is the risk that the administrator of an insolvent counterparty will "cherry-pick" from posted collateral to be returned in the event of insolvency, which will result in an increase in the risk in posting collateral.

There are only two non-netting jurisdictions where the total notional amount exceeds 0.1%¹⁵ of all uncleared derivatives transactions, shown below.

Jurisdiction	Total
CHINA	0.1893%
UNITED ARAB EMIRATES	0.1059%

Below is the count of individual firm exposures to non-netting jurisdictions grouped by percentage of total outstanding notional by (a) less than .05%; (b) between .05% & .1%; and (c) greater than .1%.

Count of exposures:	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
Less than .05%	27	34	2	16	45	16	32	8	75
Between .05% & .1%	1	2	0	2	1	2	5	1	1
Greater than .1%	1	1	2	1	1	1	5	2	2

¹⁵ Total figures were obtained by adding the sum of notional amounts across participants for each jurisdiction as a percentage of the total gross notional.

EXHIBIT C

Counterparties in non-netting jurisdictions - list of jurisdictions and total gross notional %¹⁶

Jurisdiction	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
ABU DHABI		0.0994%							0.0156%
ANDORRA		0.0003%			0.0004%	0.0009%		1.7083%	0.0197%
ANGOLA					0.0004%				0.0001%
ANTIGUA AND BARBUDA					0.0000%				0.0000%
ARGENTINA					0.0001%		0.0018%		0.0001%
BAHRAIN	0.0014%	0.0117%	0.0019%	0.0179%	0.0044%		0.2423%		0.0130%
BANGLADESH							0.0182%		0.0005%
BELIZE					0.0000%				0.0000%
BOTSWANA	0.0001%				0.0003%				0.0001%
BRUNEI DARUSSALAM					0.0053%		0.0599%		0.0024%
BULGARIA		0.0003%			0.0002%				0.0001%
BRUNEI				0.0024%		0.0031%			0.0009%
CHINA	0.1346%	0.1311%	0.4199%	0.2619%	0.1056%	0.2011%	0.6593%	0.8811%	0.1893%
COOK ISLANDS					0.0000%				0.0000%
COSTA RICA	0.0005%	0.0002%							0.0002%
COTE D IVOIRE	0.0005%	0.0004%			0.0043%		0.0912%	0.0120%	0.0033%
CROATIA		0.0027%		0.0104%	0.0011%	0.0008%			0.0030%
DJIBOUTI							0.0027%		0.0001%
DOMINICAN REPUBLIC								0.0001%	0.0000%
DUBAI		0.0160%							0.0025%
ECUADOR							0.0000%	0.0034%	0.0000%
EGYPT					0.0000%	0.0035%	0.0556%		0.0018%
ESTONIA	0.0000%	0.0003%			0.0001%				0.0001%
FRENCH POLYNESIA	0.0000%							0.0004%	0.0000%
FUJAIRAH		0.0003%							0.0000%
GAMBIA							0.0002%		0.0000%
GHANA		0.0004%					0.0058%		0.0002%
GEORGIA	0.0000%				0.0001%				0.0000%
GIBRALTAR	0.0001%	0.0044%			0.0008%				0.0008%
GUAM	0.0000%								0.0000%
HONDURAS	0.0002%	0.0015%					0.0042%		0.0004%
ISLE OF MAN		0.0068%			0.0005%	0.0011%			0.0013%
JORDAN		0.0003%			0.0000%		0.0391%		0.0010%
KAZAKHSTAN	0.0004%				0.0008%				0.0002%
KENYA		0.0038%					0.0087%		0.0008%
KIRIBATI							0.0012%		0.0000%
KUWAIT	0.0007%	0.0010%		0.0016%	0.0030%	0.0056%	0.0285%		0.0025%
LAO PEOPLE'S DEMOCRATIC REPUBLIC							0.0022%		0.0001%
LATVIA	0.0005%	0.0014%		0.0023%	0.0008%	0.0010%			0.0011%
LEBANON		0.0001%		0.0077%	0.0040%		0.0081%		0.0026%
LIBERIA	0.0007%	0.0013%			0.0067%	0.0013%			0.0017%
LIECHTENSTEIN	0.0207%	0.0148%		0.0133%	0.0179%	0.0027%	0.0133%		0.0150%
LITHUANIA	0.0011%	0.0016%		0.0020%	0.0003%	0.0019%			0.0013%
MACAU	0.0002%				0.0013%		0.0294%		0.0010%
MARSHALL ISLANDS	0.0005%				0.0030%	0.0030%	0.0006%		0.0010%
MONACO		0.0030%			0.0004%		0.0002%		0.0005%
MOROCCO		0.0044%		0.0020%	0.0002%		0.0209%		0.0017%
MOZAMBIQUE							0.0000%		0.0000%
NAMIBIA							0.0024%		0.0001%

¹⁶ Note that this is not designed to be an exhaustive list of netting and non-netting jurisdictions and has been compiled for ease of reference. Parties are always free to obtain additional opinions or seek alternative advice.

Jurisdiction	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5	Firm 6	Firm 7	Firm 8	Total
NEPAL							0.0000%		0.0000%
NIGERIA	0.0000%	0.0003%			0.0038%		0.0023%		0.0007%
OMAN	0.0029%	0.0000%			0.0010%		0.0999%		0.0035%
PAKISTAN				0.0023%			0.0282%		0.0012%
PANAMA	0.0007%	0.0017%	0.0008%	0.0050%	0.0067%	0.0032%	0.0121%	0.0565%	0.0040%
PAPUA NEW GUINEA								0.0000%	0.0000%
PUERTO RICO	0.0004%	0.0008%			0.0008%	0.0016%			0.0006%
QATAR	0.0043%	0.0188%		0.0037%	0.0039%	0.0051%	0.3305%		0.0145%
RAS AL KHAIMAH		0.0000%							0.0000%
ROMANIA		0.0001%			0.0003%		0.0013%	0.0077%	0.0002%
RUSSIAN FEDERATION	0.0109%	0.0608%		0.0426%	0.0066%	0.0114%	0.0678%		0.0263%
SAINT VINCENT AND THE GRENADINES					0.0000%				0.0000%
SAMOA					0.0000%				0.0000%
SAN MARINO					0.0000%				0.0000%
SAUDI ARABIA	0.0128%	0.0180%		0.0675%	0.0655%	0.0456%	1.2927%		0.0695%
SENEGAL							0.0085%		0.0002%
SERBIA		0.0000%							0.0000%
SHARJAH		0.0005%							0.0001%
SRI LANKA							0.0158%		0.0004%
SUDAN					0.0010%				0.0002%
TRINIDAD AND TOBAGO					0.0002%				0.0000%
TURKMENISTAN				0.0031%					0.0007%
TUNISIA							0.0009%		0.0000%
UGANDA					0.0000%		0.0000%		0.0000%
UNITED ARAB EMIRATES	0.0750%		0.1099%	0.0602%	0.0437%	0.0585%	2.2356%		0.1059%
URUGUAY	0.0002%			0.0018%	0.0000%	0.0586%	0.0132%		0.0073%
VENEZUELA	0.0017%	0.0006%		0.0039%	0.0082%			0.0246%	0.0031%
VIETNAM							0.0090%	0.0021%	0.0002%
ZAMBIA							0.0023%		0.0001%
Non netting % of Total Gross Notional	0.2711%	0.4091%	0.5326%	0.5117%	0.3042%	0.4099%	5.4160%	2.6963%	0.5247%