BARCLAYS

1 Churchill Place
Canary Wharf
London E14 5HP
United Kingdom

Tel +44 (20) 7116 1000

barclays.com

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European Banking Authority
Tower 42 (level 18)
25 Old Broad Street
London EC2N 1HQ

Dear Sirs

Draft Regulatory Technical Standards on Risk Mitigation techniques for OTC derivatives contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012

Barclays welcomes the opportunity to comment on the European Banking Authority consultation on "Risk Mitigation techniques for OTC derivatives contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012".
Barclays fully understands and is supportive of the policy objectives of the draft Regulatory Technical Standards (the "RTS"). However, we believe that the goals can be better achieved through certain alternative approaches detailed below. These approaches would also avoid the unintended consequences we see around harming EU firms' competitiveness, reducing market access, increasing operational burden without decreasing systemic risk, and in some cases increasing systemic risk.

Background

Implementing the RTS will affect all parts of our firm. We have to update our front office processes (pricing and risking), capital calculations, collateral settlement mechanisms, margin requirement calculators, all of which require major infrastructure work We need to do this within an industry framework to ensure that the resulting margin calls are agreed with counterparties from many other jurisdictions, which necessitates an unprecedented level of coordination across industry participants and regulators.

In addition, it is worth noting the scale of the client outreach/documentation effort that may be required. We have thousands of collateralised agreements (details in Annex – A)and under the current proposals in the RTS we would be required to partially or fully re-negotiate all of these prior to the 1st December 2015 implementation date. The majority of proposed requirement relates to the detailed specification of collateral eligibility and concentration rules in relation to Variation Margin (VM). The current RTS also requires that we confirm with counterparties that IM will not apply.
We have a further significant group of non-collateralised agreements (details in Annex – B) which under the proposed documentation requirements would need written confirmation for exemption. We also anticipate many third country NFC- clients that would now be caught in scope for VM even though the amount of risk attributable to these clients is very small.

We have contributed to and endorse the feedback provided by ISDA. In this letter we highlight those items in the ISDA feedback that we consider most important. We have identified these issues as the ones that typically increase cost/operational burden without any significant decrease in systemic risk, or ones that create market access issues for certain segments of the industry

Key Issues/Concerns

- Cross-Border Equivalence
  We understand that further work is required in order to identify how cross-border equivalence and harmonisation will be achieved between the regional as well as national regulators. We perceive this as a key issue given the potential requirement to satisfy requirements from multiple regulators which may be inconsistent or even contradictory.

- Third Country Entities that would be classified as NFC-
  The treatment of these entities as NFC+ will result in regulatory arbitrage as European institutions become systematically less competitive. There are numerous arguments being presented by ISDA explaining why this is contrary to other regulations, together with suggested solutions in reading the level 1 text. We endorse ISDA's response in relation to this issue

- Bilateral documentation required for non-applicability of regulations
  The requirement for agreements in writing for the exemptions (as outlined in the ISDA response) is operationally onerous and provides no additional reduction in systemic risk. Furthermore, it is likely to limit market access for smaller accounts which will be lower down the documentation prioritisation lists:
  - The current draft RTS would have the effect of placing a disproportionate burden on smaller firms or other entities who would otherwise be exempt from the margin requirements either indefinitely, or until up to December 2019, by requiring them all to enter into agreements with all their counterparties by December 2015 in order to qualify for the exemptions. This would create a significant operational burden across the entire industry to put in place such documents by December 2015, even though, as the consultation notes, only a relatively small number of entities are likely to actually be required to apply the margin rules from this date. In line with the approach taken for other EMIR RTS, entities should be allowed to rely on representations from their counterparties with respect to their status relative to EMIR Art 10, Art 1, and additionally whether they exceed the thresholds outlined in the draft RTS Art 1FP, in order to determine when they must have agreements in place.
  - Where firms do not have enough time to put together documentation with all their counterparties, smaller trading relationships are likely to have lower priorities. This will result in a reduction in trading partners for smaller counterparties, or leading them to trade outside the EU where the documentation requirements are less onerous.

- Timing/frequency of margin calls and collection
  - In order for the IM margin call process to work we need an extension to the period within which Initial Margin should be collected. Our analysis supports the ISDA recommendation of IM calls on a T+4 basis which would allow for trade reconciliation prior to initial margin calculation thus reducing the likelihood of dispute. This is particularly an issue bearing in mind the global nature of our trading relationships, and the timing issues this brings.

- Collateral
  - Collateral should be treated with trades when measuring potential change in value of the portfolio. Additionally, FX risk on trades within different asset silos should be considered together in the IR & FX silo. As they stand, the current rules will increase systemic risk, and not promote central clearing.
    Firms manage their credit risk looking across trades and collateral in the netting set where offset is legally enforceable. Capital treatment also encourages the risking of collateral with trades. However the RTS provides that collateral haircuts must be applied separately from the IM calculation resulting in double counting of FX risk, potential settlement risk, and increased credit risk (as the haircut on collateral is not proposed to be segregated). This last effect could be very significant (details see Annex – C) and outweighs the benefit obtained from the removal of VM thresholds and the collateralisation of smaller counterparties. Additionally, counterparties who benefit from receiving the 8% haircut will be incentivised not to clear/backload/novate these trades as they will lose a funding benefit.
    We endorse the IDSA paper that sets out the issues in detail with a suggested solution. The RTS goes significantly further than the BCBS/IOSCO paper, and the solution suggested by ISDA is in line with the objectives of that paper.
    Concentration rules should not apply as collateral is already subject to haircuts (or should be

included in the more advanced IM calculation – see above). Some types of firms (e.g. pension funds) will not have suitable assets in their portfolios, so they will suffer market access problems if they wish to trade with EU counterparties.
    - Collateral eligibility and concentration rules for VM will result in extensive re-negotiation with existing clients, driving up the documentation burden without reducing the system risk.

- Phasing in of Variation Margin (VM)
    - The introduction of VM without taking into account the risk that is being mitigated in each case will create a burden of documentation that will result in the reduction of market access for the smaller client base. Most of these clients have little or no Mark to Market (MtM) or risk, and therefore an approach to phasing in their requirement over the same period as the IM would not make material difference to the systemic risk. For those clients with larger risk profiles, we propose that they would be included from the initial phases. Therefore we would recommend using a risk-based phasing in approach for VM in line with the ISDA proposals. (Details of reduction in operational burden compared to residual credit risk – see Annex D)

- Modelling of Initial Margin (IM)
    - The methods suggested by the RTS are too prescriptive and will increase the burden for all firms concerned without removing any identifiable systemic risk. We agree with the ISDA proposals to allow a simpler model that everyone can use, and then rely upon ongoing back-testing to see if some of the risk factors have not been covered. As an industry, we do not have some of the risk factors required by the RTS on a consistent basis, and these cannot be developed prior to the go-live of 1st December 2015. We would recommend that, over time, we monitor and increase the risk factor granularity to address any systemic understatement of initial margin.

- Securitisations & Covered Bonds
    - We believe that the exemptions offered to covered bond pools should be extended to securitisations. Also, the requirement for swap counterparties to securitisations and covered bonds should be carved out as there are already specific risk mitigation techniques in place. We support both ISDA's and AFME's responses on these subjects.

- Novations should be not treated as new trades
    - Novations are a very important part of our risk mitigation toolkit, and allow firms to eliminate some of their credit risk. Under the current rules, for contracts originally traded before 1st December 2015 but novated after this date, the remaining party will become subject to IM/VM posting rules so it is unlikely that they will agree to the novation. If they keep the trade with the original counterparty, they will avoid this cost. Therefore we propose that novations are exempted from the regulations provided that other material economic terms of the trades are not altered.

I hope you find our comments helpful. Please do not hesitate to contact us if you have any questions or comments on any of the issues raised in this response.

Yours sincerely,

Nicholas Steele

Director, Client Capital Management, Barclays
Nicholas.Steele@barclayscapital.com
+ 44 (0)20 3134 9607

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