February 7, 2017

Authorité des Marchés Financiers
Autorité de Contrôle Prudentiel et de Résolution (ACPR)
Authoriteit financiele markten
Bank of England
Bank of Italy
Bank of Spain
Board of Governors of the Federal Reserve System
Commodity Futures Trading Commission
De Nederlandsche Bank
Department of the Treasury/Office of the Comptroller of the Currency
European Banking Authority
European Central Bank
European Commission
European Insurance & Occupational Pensions Authority
European Securities and Markets Authority
Farm Credit Administration
Federal Deposit Insurance Corporation
Federal Financial Supervisory Authority (BaFin)
Federal Housing Finance Agency
Financial Conduct Authority
Japan Financial Services Agency
Office of the Superintendent of Financial Institutions

Re: Uncleared Swap Margin Requirements – Request for Forbearance from March 1, 2017 Variation Margin Implementation

Ladies and Gentlemen,

The International Swaps and Derivatives Association ("ISDA"), the Global Financial Markets Association, including its Global FX Division ("GFMA"), The Investment Association ("IA"), Financial Services Roundtable ("FSR"), The ABA Securities Association ("ABASA"), and The American Council of Life Insurers ("ACLI") (together, the "Associations") are writing on behalf of their members to request regulatory forbearance in respect of the March 1, 2017 compliance date for the exchange of variation margin ("VM") under the regulations (the "VM regulations"), and/or pursuant to the oversight, of the authorities to which this letter has been addressed.

We respectfully request that all jurisdictions with a March 1, 2017 effective date for their VM regulations provide a transitional period during which market participants can continue to execute new derivatives transactions while they complete the necessary steps towards regulatory compliance for the relevant transactions. To ensure the most liquid and orderly markets and to minimize the operational complexity and risk associated with achieving a seamless transition to the new standards, we urge the global regulatory community to take swift actions to adopt a transitional period which is uniform with respect to both the length and the associated conditions.

It is worth noting that the majority of counterparty pairs for whom we are seeking forbearance already exchange VM, even though their current agreements may not cater to all regulatory mandated terms (though this is less the case for FX, where more counterparties have not traditionally collateralized). Based on data from a survey conducted by ISDA, amongst firms that were able to provide a breakdown of the number of CSAs that need to be amended or replaced vs. those that need to be newly executed (because the existing relationship does not include the exchange of VM), less than 12% of the total number of agreements will establish new VM exchanges. Thus the risk of under-collateralization during a transition period is limited in scope. This is quite different to the phase 1 initial margin ("IM") implementation where the majority of in-scope counterparties did not already post IM to one another.

While the systemic risk implications of granting forbearance are low, it is clear to the Associations that the documentation and operational challenges that are necessary to comply with the VM regulations by March 1st are high, despite concerted and continuing effort by our members and other market participants. A few weeks ago, ISDA began conducting a weekly survey of a core group of its members, most of whom are phase 1 dealers for regulatory IM exchange. The results of the survey confirmed anecdotal feedback that the execution of regulation compliant VM credit support annexes ("CSAs") and the operationalization of the corresponding data is currently so limited that even if substantial progress is made in the next few weeks, a substantive portion of trading relationships will be interrupted.

Variation Margin Readiness Survey
ISDA asked its survey participants to provide the following:

- the number of active CSAs[1] which require amendment or replacement
- the number of new CSAs which require execution (for previously uncollateralized relationships)
- the number of CSAs (active + new) which have been executed
- the number of CSAs (active + new) which have been both executed and updated in the firm's systems (such that trading can commence on the regulatory VM terms ("ready to trade"))

Based on data collected from 20 global dealers as of the week-ending January 27th:

- the average number of CSAs which need to be amended, replaced or executed is 7,972 (for a total of more than 159,000 for the sample 20 firms alone)
- the average combined total execution rate so far of those active and new CSAs was only 2.11%
- the average rate of the CSAs which are both executed and ready to trade was only 0.16%

Although the last two figures above have increased from the week-ending January 13th when the data was first collected, from 0.78% and 0.06% respectively, the remaining volume of CSAs involving these dealers (over 97% of them) which need to be completed and updated in systems is clearly insurmountable in under a month. Data compiled by The Securities Industry and Financial Markets Association's Asset Management Group ("SIFMA AMG") and The Investment Adviser Association[2] ("IAA"), shows that the scale of the remaining work for the non-dealer community parallels that, with 92% of the participating firms reporting the completion of 10 or fewer regulatory-compliant CSAs.

VM Readiness Challenges

<u>Scale of initiative</u>
Phase 1 market participants in the U.S., Canada and Japan began exchanging regulatory IM on September 1, 2016. Ahead of that compliance date there was concern that the relevant documentation and operational preparations could not be achieved, including the necessary

[1] "active" = has live trades plus has no trades but is flagged for repapering (e.g. because agreement has had trades within the recent past). The CSA count should be based on the actual number of agreements that need newly executed, replaced or amended (i.e. if repapering can be done at an umbrella agreement level, then this counts as "1", but if each fund need to be repapered, then each fund counts as "1").
[2] See SIFMA AMG and IAA letter from January 24, 2017: http://www.sifma.org/issues/item.aspx?id=8589964521

custodial arrangements. Ultimately, phase 1 IM exchange commenced on September 1, 2016. However, that result is not an accurate indicator for what will happen on March 1, 2017. The scale of the two initiatives is vastly different due to both the number of jurisdictions which have aligned with the March 1st effective date for their VM regulations and, importantly, the scope of counterparties that are subject to the requirements. There are approximately 20 dealers subject to the first phase of IM requirements which went into effect on September 1, 2016, while under the VM regulations, tens of thousands of market participants are pulled into scope globally.

Complexity of implementation

We believe that both market participants and the framers of the global implementation schedule underestimated how challenging this phase of the implementation would be. The requirements of the VM implementation and the participants subject to them differ significantly from those in the phase 1 IM implementation. VM implementation participants' familiarity with the regulations, ability to rapidly cope with the scale of the changes and resources to complete the requisite CSAs and implement the associated operational changes vary widely. Dealer negotiations for phase 1 IM exchange were rather straight forward since commercial terms have generally aligned over recent years amongst dealers due to having the same regulatory drivers. But the terms of existing CSAs with buy-side market participants and smaller clients are highly variable, meaning the negotiations are much more complex and take longer to complete. Further, for FX transactions in scope of the rules, many counterparties have not traditionally collateralized, thus requiring a significant amount of work that must be done to establish master agreements and CSAs. Due to the scale of these preparations, even those with greater resources will be unable to complete and operationalize enough of their CSAs by March 1 to avoid wide-scale market impact.

ISDA has published a set of protocols, supplements and self-disclosure letters that all market participants can use for their CSA repapering efforts. However, these tools are not appropriate for all situations and in many cases participants are bilaterally negotiating the terms of their amended or new VM CSAs to take into consideration the bespoke terms of their existing CSAs, including variations due to umbrella, multi-manager, '40 Act[3], and multijurisdictional agreements. Such individual negotiations are time-consuming and bandwidth issues have been reported by market participants of all sizes, despite the engagement of additional personnel and external counsel.

[3] Due to The Investment Company Act of 1940, some funds can only post collateral into a segregated custodial account over which the fund has a certain level of control. These requirements are addressed by the Segregated Amendments Supplement to the ISDA 2016 Variation Margin Protocol.

Following are some further examples of scenarios which are increasing the complexity and time to complete regulatory compliant VM CSAs:

- **Compliant terms.** Although many clients have existing CSAs that are substantially compliant with Basel guidelines (such as zero threshold, low minimum transfer amount ("MTA") and daily margin calls), few existing CSAs are fully compliant with all the specific requirements of the relevant VM regulations. Haircuts, eligible collateral, the splitting of MTAs for multi-managed funds, notification times and settlement timings are requiring bilateral negotiation. In addition, settlement timing under some regulations poses significant challenges for agreeing practicable terms that honor both the collateral substitution and rehypothecation rights of the parties.
- **Minimum transfer amount.** For clients with multiple asset managers, counterparties continue to work through the challenge of addressing MTA in transactional documents and operational workflows. Dealers and clients alike are trying to avoid an MTA of zero, where possible, because such a result increases costs and volumes of collateral transfers. At the same time, bespoke arrangements strain operational resources and complicate CSA terms.
- **Multiple regimes.** Agreeing CSA terms is further complicated by the need to comply with multiple regimes (e.g. the creation of a collateral schedule that complies with both U.S. and EU rules).
- **Non-netting.** The requirements relating to non-netting counterparties and jurisdictions create significant implementation issues, both technologically and legally, and are causing delays in agreeing approaches to VM with clients with exposure to non-netting – a category which includes many asset managers.
- **Disharmonized effective dates.** It is difficult to persuade counterparties to execute new VM CSAs ahead of March 1st if they reside in a non-G20 country (e.g. Thailand, Philippines), a country where the margin rules are not finalized (e.g. India, Korea) or where VM requirements have not yet commenced (e.g., Switzerland). In some cases, progress has been impacted by messages from local regulators indicating to parties in their jurisdiction that a later local effective date can be applied.

Operational risk

Even if there is significant progress in the CSA repapering effort prior to March 1st, the new or revised CSA terms have to be updated in firms' systems and activated for application to the relevant portfolio. Based on the data collected by ISDA as part of its survey, as of the week-ending January 27th, just 10.51% of the CSAs for which the requisite amendments or execution has already completed have been updated in the firms' systems so that trading could commence on regulatory-compliant VM terms. Although most firms are increasing staff to try to address the demand, if hundreds or even thousands of executed CSAs have to be operationalized in the last half of February, the work will not be completed and some trading relationships will be temporarily halted.

Potential for market disruption

Given the challenges discussed above and the overwhelming demand for resources dedicated to compliance efforts for the March 1 deadline, firms are forced to prioritize their CSA negotiations with the initial focus placed on the most active clients that represent the greatest portion of a firm's derivatives trading activity. As a result, buy-side market participants and smaller clients that rely on derivatives to hedge their exposures may not be able to complete the requisite documentation, will be cut-off from trading with firms subject to the VM regulations, may be unable to access the liquidity they need and would remain unhedged. Thus for some market participants, March 1st will mean an increase in their overall market risk rather than a reduction of their derivatives risk. Alternatively, they may be forced to shift trading to relationships in regions not subject to the March 1 deadline or where transitional relief is available, leading to market fragmentation. We understand from our members that market fragmentation is anticipated, with some market participants expecting they may only be in a position to trade new derivatives with a limited number of local dealers. The prospect of either cutting buy-side market participants and financial end-users out of the market or otherwise limiting their access to liquidity is likely to have an enormous impact on market liquidity at a time when political events in some jurisdictions are increasing the need for hedging.

It is not essential that all CSAs be compliant with the VM regulations in order for participants to retain access to markets, preserve liquidity, and prevent market fragmentation, but a substantive enough portion covering an array of market participants is necessary to avoid widespread market disruption. We project based on available data today that there is a material risk of such a disruption.

Forbearance

A cessation in derivatives trading by and between significant portions of market participants would result in market fragmentation, market disruption, higher prices and the potential for a lack of access to hedging. Therefore, the Associations jointly support the requests made by (i) SIFMA AMG and IAA [4], (ii) The Committee on Investment of Employee Benefit Assets Inc. ("CIEBA") and The ERISA Industry Committee[5] ("ERIC") and (iii) ACLI[6] for all jurisdictions with a March 1, 2017 effective date for VM regulations to provide a transitional period during which market participants can continue trading derivatives while they (i) complete the execution of new and amended CSAs and (ii) update the data in their systems in order to apply the regulatory compliant VM terms to their VM calculations and settlement.

Although retrospective application of regulatory VM terms would create challenges with respect to pricing and capital treatment of impacted transactions, our members are able and willing to meet such conditions, if required. We recognize that forbearance which leaves intact the application of the March 1, 2017 compliance date is more palatable and would uphold a level playing field in which the incentive to complete the legal and operational measures for compliance is retained. We caution, however, that addressing the impacts of retrospective application of the VM regulations will divert resources from the essential task of completing documentation and operational changes. Thus, the benefit of increased risk mitigation which retrospective application may achieve should be carefully weighed against the goal of reaching a state of readiness for compliance with the VM regulations for a wide array of market participants and which is sufficient to protect and preserve the integrity of the derivatives market.

For the sake of clarity and to promote uniform regulatory application, if it were to be required, any retrospective application of the VM regulations means that prior to the completion of the relevant regulation compliant VM CSA and its operationalization ("VM Readiness Day One"), a pair of counterparties would continue to exchange VM in accordance with their existing CSA, if

[4] SIFMA AMG letter from December 16, 2016: http://www.sifma.org/issues/item.aspx?id=8589963951
SIFMA AMG and IAA letter from January 24, 2017: http://www.sifma.org/issues/item.aspx?id=8589964521
[5] CIEBA and ERIC letter from January 24, 2017: http://www.cieba.org/assets/Comment_Letters/CIEBA%20Letter%20re%20March%202017%20VM%20Implementation.pdf
[6] On January 24, 2017, ACLI submitted a *Request for Qualified Temporary Relief from March 1, 2017 Variation Margin Implementation* with the: Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, European Banking Authority, European Commission, European Insurance and Occupational Pensions Authority, European Securities and Markets Authority, Farm Credit Administration, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Japan Financial Services Agency, Office of the Comptroller of the Currency, UK Financial Conduct Authority.

applicable. Then once the parties are "ready to trade" on the regulatory compliant VM CSA, the portfolio would include all trades from March 1, 2017 which are subject to VM requirements, and from the relevant VM Readiness Day One and going forward the parties would calculate the VM for the entire portfolio and exchange it in accordance with the terms of their regulatory compliant VM CSA.

Due in particular to the global nature of the VM regulations, emanating from the G20 commitments, it is vital that any relief be coordinated globally so as to prevent any regulatory arbitrage, and to avoid the fragmentation of markets. We would therefore urge regulators globally to coordinate their approach to any relief given. In accordance with the enormous effort and coordination required to prepare for compliance with the VM regulations, regulators in Hong Kong, Singapore and Australia have provided for a transition period of six months until September 1, 2017. The Associations understand that as much as six months may be needed by many market participants to complete the legal and operational processes to comply with VM regulations. Therefore to mitigate market disruption and promote a harmonized industry adoption and implementation without staggered implementation timings, we request a uniform transitional period that is sufficient to meet the needs of all market participants and which is conditioned on good faith conformance efforts by the relevant market participants. We further request that the conditions of such relief, including the retrospective application of regulatory-compliant VM terms, be uniform across regimes.

The Associations and our members strongly believe that regulatory forbearance with respect to the VM regulations strikes an appropriate balance between upholding the integrity of the regulations while preserving an open and stable derivatives market.

Thank you for your consideration and please contact us if you have any questions.

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FINANCIAL SERVICES ROUNDTABLE
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ABA Securities Association
ABASA, an ABA subsidiary
ACLI Financial Security...for Life.

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American Council of Life Insurers

About the Associations

The International Swaps and Derivatives Association
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 66 countries. These members comprise a broad range of 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, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

The Global Financial Markets Association
The Global Financial Markets Association (GFMA) represents the common interests of the world's leading financial and capital market participants, and speaks for the industry on the most important global market issues. GFMA's mission is to provide a forum for global systemically important banks to develop policies and strategies on issues of global concern within the regulatory environment.

GFMA brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

The Global FX Division of the GFMA was formed in co-operation with AFME, SIFMA and ASIFMA. Its members comprise 25 global foreign exchange market participants, collectively representing around 85% of the FX inter-dealer market.

The Investment Association
The Investment Association is the trade body that represents UK investment managers, whose members collectively manage over £5.5 trillion on behalf of clients.
Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so that everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity

o Help people achieve their financial aspirations
o Enable people to maintain a decent standard of living as they grow older
o Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world, after the US and manages 37% of all the assets managed in Europe.

Financial Services Roundtable

FSR represents nearly 100 of the largest U.S. integrated financial services companies providing banking, insurance, financial and investment products and services to American consumers. FSR member companies directly account for $54 trillion in managed assets, $1 trillion in revenue and 2 million jobs.

ABA Securities Association

The ABA Securities Association (ABASA) is a separately chartered trade association and non-profit subsidiary of the American Bankers Association whose mission is to represent the interests of banks underwriting and dealing in securities, proprietary mutual funds and derivatives before Congress and the federal government.

American Council of Life Insurers

The American Council of Life Insurers (ACLI) is a national trade association with 280 member companies representing 95% of industry assets, 92% of life insurance premiums, and 97% of annuity considerations in the United States. ACLI's members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance that 75 million American families rely on for financial and retirement security.

Life Insurers have provided constructive input on numerous rulemakings implementing Title VII of the Dodd Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act" or DFA) and parallel global initiatives. Several of the initiatives on which we offered comment are interrelated with the uncleared swap margin requirements.[7]

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[7] For example, ACLI submitted detailed comments on the following related and parallel regulatory proposals developed by the U.S. Prudential Regulators, the U.S. Commodity Futures Trading Commission ("CFTC"), and the U.S. Securities and Exchange Commission ("SEC") governing margin and capital requirements:

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities; [http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf] [Prudential Regulators];
- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson] [CFTC];

Life insurers are significant *end-users* of derivatives for prudent asset/liability risk management. Unlike many other financial institutions, life insurers have unusually long-term liabilities that must be matched with assets of equivalent duration. Like other commercial end users, life insurers must hedge their risks. Life insurers' derivatives use is highly regulated by state law, and life insurers cannot, by law, engage in market speculation.

Life insurance companies already exchange variation margin on a daily basis with zero to low thresholds, consistent with life insurers' relatively conservative risk appetite. Derivatives allow life insurers to prudently manage the credit and market risk of their portfolios and to fulfill their long-dated obligations to policy and contract owners.

Life insurers' collateral is drawn from their long-term portfolios, which are significant to the economy as a whole. Life insurers are the largest institutional investor in U.S. corporate bond financing; approximately 49% of life insurers' $6.5 Trillion total assets in 2016 were held in bonds, with 33% composed of corporate bonds. Over 38% of corporate bonds purchased by life insurers have maturities exceeding 20 years (at the time of purchase). Implementation of a forbearance from the March 1, 2017 variation margin implementation would benefit the U.S. economy, as explained above and would enhance prudent management of asset and liability risks.

- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson] [CFTC];
- SEC proposal on margin, capital and segregation for security-based swap dealers and major security-based swap participants [http://www.sec.gov/comments/s7-08-12/s70812-25.pdf]; and,
- Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf].

ACLI also submitted comments on the initial BCBS-IOSCO Consultative Document for Non-Centrally Cleared Derivatives, published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (May 2012) ("BCBS-IOSCO Consultative Paper") [http://www.bis.org/publ/bcbs226/acoli.pdf] [BCBS-IOSCO], and the BCBS-IOSCO Second Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives (Feb. 2013) ("Second BCBS-IOSCO Consultative Paper") [http://www.bis.org/publ/bcbs242.pdf].

On August 4, 2015, ACLI filed comments on the Prudential Regulators' net stable funding ratio proposal. finalized by the Basel Committee on Banking Supervision as part of Basel III, as Regulatory Agencies were considering a similar proposal for entities under their authority.

On July 5, 2016, ACLI filed comments on the BCBS Revised Basel III Leverage Ratio Framework-Consultative Document published April 25, 2016. The submission explained that life insurers are among the financial end users affected by the leverage ratios under consideration in the Consultative Document. ACLI previously filed a submission dated September 20, 2013, with the Basel Committee on Banking Supervision (BCBS) on its initial consultative document that proposed a revised Basel III leverage ratio framework through a supplementary measure of the Risk Based Capital ("RBC") requirements for Banks.

ACLI filed comments on a draft ISDA Variation Margin Protocol on July 29, 2016. ACLI suggested that parties adhering to the VM Protocol should be given additional options for items such as Notification Time, Independent Amount, Transfer Timing and Collateral Eligibility, among other things.