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TO:
The Banking Research and Regulation Department
Otoritas Jasa Keuangan (OJK)
Indonesia

Via email: Aninda.nusratina@ojk.go.id

November 27, 2020

Re: Consultative Paper – Margin Requirements for Non-Centrally Cleared Derivatives

Dear Banking Research and Regulation Department,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the *Consultative Paper – Margin Requirements for Non-Centrally Cleared Derivatives* (the "Consultative Paper") issued by the OJK in August 2020.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants,[1] collectively representing a significant portion of the foreign exchange inter-dealer market. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

[1] Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, Northern Trust, RBC, RBS, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasize the desire of our members for globally coordinated regulation which we believe will be of benefit to both regulators and market participants alike.

The FX market is also the basis of the global payments system. The volume of transactions is therefore very high and these transactions are often executed by market participants across geographical borders. As reported by the Bank for International Settlements (BIS) in their 'Triennial Central Bank Survey: Foreign Exchange Turnover' in April 2019, sales desks in five countries – the United Kingdom, the United States, Hong Kong SAR, Singapore and Japan – facilitated 79% of all foreign exchange trading,[2] hence the view from the GFXD that regulations should be harmonised at the global level. Cross border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation of what is an already highly automated and transparent FX market.

EXECUTIVE SUMMARY

Whilst we support the OJK taking initiatives to implement the G20 commitments to reform the OTC derivative market, we highlight below some key points of particular importance to our members from an FX perspective. We respectfully ask these points are taken into account by the OJK in finalizing the relevant rules, in order to preserve robust market liquidity and avoid causing any bifurcation of the FX market.

In several places in our comments we reference the letter submitted to you in response to this Consultative Paper by The International Swaps and Derivatives Association, Inc. (ISDA).

To summarise our comments:

1. **Exclusion of physically-settled FX swaps and forwards from variation margin**: To achieve alignment with other regulators around the world, we urge the OJK to exempt physically-settled FX swaps and physically-settled FX forwards from mandatory regulatory variation margin ("VM"). We suggest an alternative mechanism, more in line with other countries, whereby any VM expectations could instead be accomplished via OJK supervisory guidance.

2. **FX spot/ FX security conversion transactions**: FX spot, and "FX security conversion transactions" entered into in connection with the funding of a purchase or sale of a foreign security, should be excluded from any margin requirements.

[2] BIS 2019 Triennial Survey, available at https://www.bis.org/statistics/rpfx19_fx.pdf

3. **Support for comments made by ISDA.** We also wish to express our support for the following comments made by ISDA in their letter to you in response to the Consultative Paper:

    a. **Close-out netting:** We support the points ISDA makes around close-out netting arrangements, to build the foundation that needs to be laid for an effective margining regime for non-cleared derivatives in Indonesia.

    b. **Local custodian network for IM:** Time should be allowed for the development of IM third party custodial service provider(s) in Indonesia prior to the effective date of the margin requirements.

    c. **Types of eligible collateral – term:** We request that the OJK remove from the eligible collateral requirements the criteria that the types of eligible collateral require high quality government and central bank securities, high quality corporate bonds and high quality covered bonds to be of a "term of which is longer than the term of the derivatives contract".

    d. **Eligible collateral/FX haircut:** We suggest the OJK adopt a formulation for applying the FX haircut more similar to the BCBS IOSCO International Margin Framework.

    e. **IM schedule:** We request that the OJK remove the requirement to use only the standardized IM schedule, and allow the use of IM models including the ISDA SIMM™.

    f. **Variation margin re-hypothecation:** We request that the OJK permit re-hypothecation of VM and not require that VM be segregated, to allow for a more efficient use of collateral and free up liquidity of such collateral.

    g. **Inter-affiliate transactions:** We support the OJK exempting transactions with affiliates from the scope of margin requirements and, if the OJK intends to include transactions with affiliates in the future, request that the OJK consult with market participants ahead of this.

    h. **Substituted compliance:** Ideally, the OJK should allow full substituted compliance for those jurisdictions that have implemented BCBS IOSCO International Margin Framework margin regulations, in line with other global regulators, including those in Asia.

    i. **Legacy derivatives:** We request that the OJK only require margin requirements to be applied to new non-centrally cleared derivatives contracts entered into on or after the effective date of the margin requirements, and

exclude Legacy Derivatives and genuine amendments to them from margin requirements. Viewing the aggregate end-of-month average notional amount retrospectively and applying the margin requirements retroactively, is inconsistent with the approach taken in other jurisdictions.

j. **Implementation timeline**: We respectfully ask the OJK to ensure that, in establishing final margin rules, the implementation timeline provides sufficient lead time given the documents and processes that would need to be put in place from a legal and infrastructure standpoint to facilitate the exchange of margin.

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We set out below our detailed comments.

1. Exclusion of Physically-settled Foreign Exchange (FX) Swaps and Physically-settled FX Forwards from Margin Requirements

We welcome and support the OJK's exemption of physically-settled FX swaps and forwards from initial margin ("IM") requirements. However, for the reasons set forth below, we urge the OJK to exempt physically-settled FX swaps and physically-settled FX forwards from mandatory regulatory VM as well.

International Harmonization of VM Expectations

Looking at the current global regulatory landscape, it can be seen that physically-settled FX swaps and forwards have overwhelmingly been excluded from regulatory VM under final margin rules:

Physically-settled FX swaps and forwards included / excluded for VM under final uncleared margin rules							
U.S.	Excluded	Singapore	Excluded	Europe	Excluded[3]	Brazil	Excluded
Japan	Excluded	Australia	Excluded	Hong Kong	Excluded	South Africa	Excluded

[3] Amendments made to the relevant EU regulations, which are in the final stages of enactment, allow parties to exclude physically-settled FX swaps and forwards from VM where one or both counterparties are not "Institutions" ("credit institutions" / "investment firms") under the EU Capital Requirements Regulation ("CRR"). These amendments were made to avoid regulatory divergence between the EU and other jurisdictions in respect of the exchange of VM for physically-settled FX swaps and forwards by essentially limiting VM only to transactions between the most systemic counterparties (e.g., "dealer-to-dealer"), where the exchange of VM for physically-settled FX swaps and forwards is already common practice.

Canada	Excluded	Switzerland	Excluded	Korea	Excluded		

If the OJK were to apply regulatory VM to physically-settled FX swaps and forwards as per the Consultative Paper, the OJK would therefore take a contrasting approach compared with other countries around the world, as illustrated above.

An important element of the BCBS IOSCO International Margin Framework[4] is the goal of promoting global consistency and reducing regulatory arbitrage opportunities with respect to the treatment of physically-settled FX swaps and forwards. We are concerned that the OJK's approach under the Consultative Paper could create an uneven playing field for Indonesia, and incentivize regulatory arbitrage. If this were to result, we would have concerns about potential impacts on pricing and liquidity.

In order to avoid inconsistency in VM treatment for physically-settled FX swaps and forwards in Indonesia compared with other jurisdictions, we urge the OJK to exclude physically-settled FX swaps and physically-settled FX forwards from the scope of VM under final margin rules, as it does with IM. As an example, we point to the specific carve-outs implemented in the Hong Kong[5] and Singapore[6] uncleared margin regulations.

VM for Physically-settled FX via BCBS Supervisory Guidance

In light of the above, to the extent the OJK still wants to establish VM expectations for these physically-settled FX products, a preferable and more globally consistent approach to VM for physically-settled FX swaps and forwards would be to establish any such expectations via the 2013 BCBS FX Supervisory Guidance[7].

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[4] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD651.pdf

[5] HKMA "Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards", available at: https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CR-G-14.pdf (See section 2.1.2(iii) on p. 9).

[6] MAS "Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Contracts", available at: https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Fund-Management/Regulations-Guidance-and-Licensing/Guidelines/Guidelines-on-Margin-Requirements-for-NonCentrally-Cleared-OTC-Derivatives-Contracts-8-Apr-2020.pdf (See section 4.2 on p. 5).

[7] Available at http://www.bis.org/publ/bcbs241.pdf

There are examples of how this was done in Singapore by the MAS[8], in the US by the Federal Reserve System[9] and in Canada by the Office of the Superintendent of Financial Institutions Canada (OSFI)[10] Additionally, the HKMA has taken a similar approach in Hong Kong.[11]

The OJK is correct where the Consultative Paper notes that the exchange of VM for physically-settled FX swaps and forwards is already common practice for "significant market players" (i.e., dealer-to-dealer transactions). Rather than impose mandatory and stringent regulatory VM requirements on ***all*** entities within scope of the OJK's VM requirements for physically-settled FX forward and swaps, a supervisory approach would allow for a more risk-based application of VM for these FX products in Indonesia, and ensure VM is limited in respect of physically-settled FX transactions to where it is deemed necessary and appropriate in light of the risks posed. In our view, this would achieve closer and better alignment with the path adopted in other jurisdictions, whilst still enabling an approach that ensures the relevant risks are adequately addressed.

Finally, in addition to the challenges which arise where regulatory approaches are not consistent between regulatory bodies, we note that implementing necessary capabilities for mandatory exchange of VM for physically-settled FX swaps and forwards requires significant cost, infrastructure build, creation of a counterparty classification/categorization system, as well as the commitment of cash or other liquid assets as collateral.

It is crucial to ensure that regulatory obligations take into account and reflect the nature and extent of the risks posed and that are to be mitigated, and avoid unnecessary burdens on FX end-users. If the obligations are not commensurate with the risks posed, entities within scope of the OJK's VM requirements may be challenged in managing their currency risk through the use of physically-settled FX swaps and forwards, and their counterparties who do not themselves bear these obligations under their own regulatory framework may be deterred from trading with them, which could have adverse liquidity impacts.

Conclusion

Physically-settled FX swaps and forwards are relied upon by entities around the world to hedge currency risk exposures, so coordinated regulation in respect of these straightforward, predominantly short-dated FX products is vital. In order to achieve better global consistency across jurisdictions, both to maintain the competitiveness of entities subject to the OJK's regulatory scope and to avoid potential jurisdictional conflicts, we urge the OJK to follow the

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[8] See http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Policy%20Consultation%20on%20Margin%20Requirements%20for%20NonCentrally%20Cleared%20OTC%20Derivatives%201Oct.pdf (Footnote 7)

[9] See http://www.federalreserve.gov/bankinforeg/srletters/sr1324.htm

[10] See http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/adv-prv/Pages/FXSR.aspx

[11] https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2013/20130219e1.pdf

approach taken by other regulators globally and exempt physically-settled FX swaps and physically-settled FX forwards from mandatory regulatory VM requirements under final margin rules.

2. FX Spot / FX Security Conversion Transactions

First, we would appreciate the OJK clarifying that FX "spot" transactions, not being derivatives, are entirely excluded from the proposed margin requirements. In general, an FX transaction is considered a bona fide spot transaction if it settles via an actual delivery of the relevant currencies within two business days (T+2) or the period generally accepted in the market for that currency pair as the standard delivery period.

We also urge the OJK to classify as spot (and thus exclude from any margin requirements) FX transactions entered into in connection with the funding of a purchase or sale of a foreign security, even where the settlement period for the securities transaction, and thus the accompanying FX transaction, is greater than T+2. This would be consistent with the classification of these types of "FX security conversion" transactions in other jurisdictions.

Many of our members act as custodian for their customers who are asset managers. Due to increased access to, and investor interest in, foreign financial markets, growing numbers of these customers are invested in foreign securities. To facilitate the purchase or sale of these foreign securities, custodians, as part of their service offering, often enter into an FX transaction that is incidental to and for the purpose of effecting their customer's foreign security transaction. For example, when a non-US customer wishes to purchase a US dollar-denominated security, its broker-dealer or bank custodian will enter into a corresponding FX transaction so that the customer has US dollars available to meet the cash currency requirements necessary to complete purchase or sale of the security. These FX transactions are integral to the settlement of the security.

Typically, the settlement cycle for most non-EUR denominated securities is trade date plus three days (T+3). Accordingly, the bank custodian or broker-dealer would enter into a FX transaction with its customer on a T+3 basis as well. In some securities markets, for example in South Africa, the settlement cycle can take up to seven days (T+7).

Subjecting FX transactions that are incidental to related securities transactions to OTC derivatives regulation would expose bank custodians, broker-dealers and their customers to needless operational, price, credit and other risks. As a result, participants may restrict FX security conversion transactions to T+2 FX spot contracts, even when the related securities settlement takes longer, thereby exposing the customer to misalignment and FX risk while exposing the bank to certain operational risks and changing, and disrupting, the long-standing and well-functioning settlement processing for the systemically relevant securities markets that exists today.

Applying margin requirements to the types of incidental transactions so described will not provide any meaningful protection to participants. Physically-settled FX forwards and swaps are mostly used for hedging underlying exposures and do not give rise to a very high amount of potential future exposure. Inconsistent treatment of these transactions globally should be avoided in order to ensure that the lack of an exclusion for FX security conversion transactions from OTC derivatives/margin requirements regulation in some jurisdictions, such as Indonesia, doesn't create unnecessary disincentives from transacting in securities in those jurisdictions by raising their transactional costs relative to other jurisdictions which have excluded FX security conversion transactions, such as the United States and EU.

3. Support for comments made in ISDA's letter to the OJK regarding the margin requirements under the Consultative Paper

We also wish to express our support for comments made by ISDA in its response to the Consultative Paper:

a. **Close-out netting.** To ensure a foundation is laid for an effective margining regime for non-cleared derivatives in Indonesia, we express our support for the points ISDA makes in its letter (Section 2.a.) around close-out netting arrangements. We also urge the OJK to work with Bank Indonesia and the relevant other policymakers in Indonesia to introduce a legislative solution to provide certainty in respect of the enforceability of close-out netting in Indonesia prior to implementing the margin requirements proposed in the Consultative Paper.

b. **Local custodian network for IM.** As ISDA states in Section 2.e. of its letter, time should be allowed for the development of IM third party custodial service provider(s) in Indonesia prior to the effective date of the margin requirements. We agree with ISDA there is a need for the establishment of one or more third party custodial service provider(s) in Indonesia that have infrastructure set up to comply with the IM requirements under the margin requirements prior to their effective date. We also agree that any third party custodial infrastructure established in Indonesia should also allow Indonesian branches of foreign banks to comply with the IM segregation and other requirements under the margin rules of their home jurisdictions (e.g., requirements in relation to credit quality of the custodian and account structures).

c. **Types of eligible collateral – term:** As ISDA notes in its letter (Section 3.d.II), the types of eligible collateral referred to in paragraph 42 and Appendix B of the Consultative Paper require high quality government and central bank securities, high quality corporate bonds, and high quality covered bonds to be of a "term of which is longer than the term of the derivatives contract". We agree it is important to note that margin is exchanged on a portfolio basis rather than on a per transaction/derivatives contract basis, and hence it will be difficult for market participants to ensure that the

collateral meets such criteria. As ISDA also notes, such a requirement is also not in line with the BCBS-IOSCO International Margin Framework. We therefore also request that the OJK remove such criteria from the eligible collateral requirements.

d. **Eligible collateral/FX haircut.** We suggest the OJK adopt a formulation for applying the FX haircut more similar to the BCBS IOSCO International Margin Framework. The Consultative Paper notes that where the eligible collateral is in a foreign currency having high liquidity, as appropriate haircut should apply to reflect the inherent FX risks. To be consistent with the BCBS IOSCO International Margin Framework and other jurisdictions, this is usually phrased where the currency of the collateral is different from the settlement "termination" currency of the relevant contract governing the transactions. We request that the OJK also adopt a similar formulation for applying the FX haircut. OJK may also consider disapplying the FX haircut for cash that is provided as collateral for VM, which is the approach under the margin rules in Singapore, Hong Kong, Australia and Korea.

e. **IM schedule.** We support and reiterate the comments made by ISDA in its letter (Sections 2.c. and 3.c. I.) regarding removal of the requirement to use only the standardized IM schedule and allowance of the use of IM models, including the ISDA Standard Initial Margin Model (ISDA SIMM). We are concerned that the OJK's proposal in this respect is inconsistent with the BCBS IOSCO International Margin Framework and the margin regimes in other jurisdictions.

f. **Variation margin re-rehypothecation.** We agree with ISDA and request that the OJK permit re-hypothecation of VM and to not require that VM be segregated. This would allow for a more efficient use of collateral, free up liquidity of such collateral and be more consistent with other jurisdictions.

g. **Inter-affiliate transactions.** We support the OJK exempting transactions with affiliates from the scope of margin requirements. If the OJK intends to include transactions with affiliates in the future, we ask that the OJK consults with market participants ahead of this.

h. **Substituted compliance.** Given the importance of cross-border transacting to the global FX market, we agree with and support ISDA's request (in Section 3.g.II of its letter) to the OJK to explicitly set out the jurisdictions with margin rules deemed or assessed to be comparable to the Indonesia margin requirements and which may be applied as substituted compliance under the margin requirements. Ideally, we ask that the OJK follow a similar approach to Singapore and Hong Kong and state that all BCBS-IOSCO jurisdictions are comparable. Alternatively, we the OJK could set out a list of comparable jurisdictions that is available prior to the margin requirements becoming effective. Such an approach would assist the OJK in achieving a workable cross-border framework.

i. **Legacy derivatives.** As requested by ISDA in Section 3.h.I. of its letter, we ask that the OJK only require margin requirements to be applied to new non-centrally cleared derivatives contracts entered into on or after the effective date of the margin requirements, and exclude Legacy Derivatives from margin requirements. Viewing the aggregate end-of-month average notional amount retrospectively and applying the margin requirements retroactively, is inconsistent with the approach taken in other jurisdictions. We also ask that genuine amendments to Legacy Derivatives not qualify as a new non-centrally cleared derivative contract and therefore do not bring the transaction into the scope, as raised in Section 3.h.II. of ISDA's letter.

j. **Implementation Schedule:** Even if physically-settled FX swaps and forwards are fully excluded from the scope of final margin rules, as we request, the margin requirements will be a significant policy change for most market participants in respect of other derivatives/FX derivatives that are in scope, such as FX non-deliverable forwards (NDF) and FX options. The new margin requirements will call for documentary needs, operational enhancements and additional amounts of collateral for which liquidity planning will have to be undertaken by entities within scope.

   Final margin rules are required before firms will be able to begin necessary work, including legal, documentary, technology systems, operational and risk management work, all of which will take some time. We therefore urge the OJK to ensure the relevant implementation periods provide sufficient lead time.

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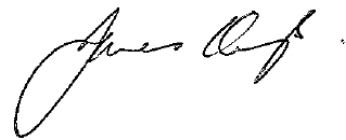
We appreciate the opportunity to share our views on the Consultative Paper. Please do not hesitate to contact John Ball on +852 2531 6512, email jball@gfma.org or Victoria Cumings on +1 212 313 1141, email vcumings@gfma.org should you have questions about our comments or wish to discuss any of the above.

Yours sincerely,



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