# Basel Committee and IOSCO Release Consultation Paper on Uncleared Derivatives Margin; CFTC Reopens Comment Period on Uncleared Swap Margin Proposal

On July 6, the Basel Committee on Banking Supervision (the "**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**") released a consultation paper on margin requirements for uncleared derivatives (the "**BCBS/IOSCO paper**"). In response, the CFTC reopened the comment period for its proposed rule on margin requirements for uncleared swaps until September 14, 2012.

The BCBS/IOSCO paper is similar in many important ways to the proposals issued by the CFTC and banking regulators under Dodd-Frank (the "**U.S. regulators' proposals**"). For example, in order to decrease systemic risk and promote clearing, the BCBS/IOSCO paper and the U.S. regulators' proposals both generally endorse subjecting uncleared transactions between financial entities to initial and variation margin requirements and would not allow initial margin amounts to be netted between the two counterparties to the transaction. However, the BCBS/IOSCO paper differs from the U.S. regulators' proposals in a number of critical ways. For example, the BCBS/IOSCO paper:

- suggests applying uncleared margin requirements to all over-the-counter derivatives, including derivatives that are not part of the Dodd-Frank Title VII regime and foreign exchange forwards and swaps that are likely to be exempt from such requirements by the U.S. Secretary of the Treasury;[1]
- endorses, where margin is required, the bilateral exchange of initial and variation margin with set minimum amounts for all over-the-counter derivatives, including uncleared swaps, while the U.S. regulators' proposals would only require swap dealers ("**SDs**") and major swap participants ("**MSPs**") to collect margin and would not require their non-SD/MSP counterparties to collect margin;
- considers various possibilities for margin collection threshold levels that, in some cases, differ based on whether the counterparties are both prudentially regulated or are "key market participants" (a term that is not defined), while the U.S. regulators' threshold allowance instead would depend on a division of counterparties into SDs/MSPs, high-risk financial end users, low-risk financial end users and commercial end users;
- contemplates segregation of initial margin or equivalent protections as well as a ban on rehypothecation in all cases, while the U.S. regulators' proposals would require segregation for interdealer trades but would provide the non-SDs/MSPs the option whether to have the initial margin that they post segregated;
- suggests that eligible collateral would include any sufficiently liquid instrument and specifically mentions cash, high-quality government and central bank securities, high-quality corporate bonds,

[1] The BCBS/IOSCO paper does, however, ask for comment on whether FX swaps and forwards with a maturity of less than a specific tenor (such as one month or one year) should be excluded.

high-quality covered bonds, equities included in major stock indices and gold, which is a broader set of eligible collateral than in the U.S. regulators' proposals;[2]

- endorses subjecting interaffiliate transactions to variation margin requirements[3] but leaves the initial margin treatment of interaffiliate transactions to local regulators, while the U.S. regulators' proposals are silent on the issue of margin requirements for interaffiliate swaps and thereby do not differentiate interaffiliate swaps from third-party swaps; and
- suggests that legal entities[4] should be subject to the margin requirements of the jurisdiction in which they are established and home-country supervisors should permit an entity to comply with the margin requirements of a host-country margin regime as long as the home-country supervisor considers the host-country margin regime to be consistent with the BCBS/IOSCO standards, while the U.S. regulators' proposals, instead, would generally apply U.S. margin requirements to non-U.S. SDs globally in their transactions with U.S. persons.

Like the U.S. regulators' proposals, the BCBS/IOSCO paper would allow for portfolio margining with the same counterparty under a single, legally enforceable netting agreement.[5] Additionally, the BCBS/IOSCO paper would allow the use of models approved by a supervisor. However, the proposal does not provide detailed guidance concerning the criteria to be applied in approving models and would benefit from further development that would provide greater clarity to the parties involved. For those entities that do not use models, BCBS and IOSCO have provided a simpler and less risk-sensitive margin grid. Local supervisors would be allowed to permit entities to use models that are part of their existing local capital regimes if such models require margin levels at least as conservative as the BCBS/IOSCO grid.

The BCBS/IOSCO paper acknowledges concerns raised by the SEC regarding the greater impact that the proposals would have on U.S. broker-dealers subject to the SEC's net capital rule. BCBS and IOSCO plan to conduct a quantitative impact study during the consultation period to gauge the impact of the margin proposals. Comments on the BCBS/IOSCO paper are due by September 28, 2012.

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[2] The U.S. regulators' proposals limit eligible collateral between financial entities to cash, U.S. government obligations and (for initial margin requirements only) senior government sponsored entity obligations.

[3] The BCBS/IOSCO paper notes some members' view that actual exchange of variation margin among affiliates should not be required in some cases.

[4] For this purpose, a branch would not be considered a separate legal entity, but a subsidiary would.

[5] Effectiveness of the netting agreement under the laws of the relevant jurisdictions must be supported by periodically-updated legal opinions.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.


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