Coalition for Derivatives End-Users

February 23, 2015

Ms. Rohini Tendulkar
International Organization of
Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

VIA EMAIL: consultation-2014-09@iosco.org

Re: ***Public Comment on the Task Force on Cross-Border Regulation***

Dear Ms. Tendulkar:

I. Introduction

The Coalition for Derivatives End-Users (the "Coalition") is pleased to respond to the request for comments on the consultation report prepared by the IOSCO Task Force on Cross-Border Regulation (the "Consultation") and published by the International Organization of Securities Commissions ("IOSCO") Board. The Coalition represents end-user companies that employ derivatives to manage risks. Hundreds of companies have been active in the Coalition on both legislative and regulatory matters and our message is straightforward: financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users. Imposing unnecessary regulation on derivatives end-users, who did not contribute to the financial crisis, would fuel economic instability, restrict job growth, and decrease productive investment.

End-users predominantly use derivatives to hedge or mitigate commercial risk. The use of derivatives to hedge commercial risk benefits the global economy by allowing a range of businesses—from manufacturing to healthcare to agriculture to technology—to improve their planning and forecasting and offer more stable prices to consumers and a more stable contribution to economic growth.

II. The Coalition Supports an Outcomes-Based Recognition Approach for Equivalence

Cross-border harmonization is particularly important for derivatives end-users, as many end-users have affiliates located across the globe in several jurisdictions. Inconsistencies in derivatives regulations lead to duplication, increased costs and confusion that could lead end-users to abandon efficient hedging practices or cause companies not to hedge at all. Global derivatives regulators should work to find equivalency with foreign regulatory regimes using an outcomes-based recognition approach, as noted in the Consultation.[1] We recognize that differences in regulation may be necessary in certain circumstances; however, global regulators should seek to avoid such differences. A reasoned outcomes-based recognition approach to evaluating comparability will reduce costs and duplicative regulations to market participants, including end-users.

Absent such an outcomes-based approach, end-users will face uncertainty with respect to which requirements apply to them, and duplication when faced with similar requirements from each jurisdiction. This duplication is especially evident and problematic when an end-user conducts a competitive auction amongst its counterparties to obtain efficient market pricing. If the end-user, for example, bids a transaction to three counterparties, each subject to different regulatory and substituted compliance regimes, the mix of regulatory requirements that could apply to the end-user transaction may vary considerably depending on the counterparty that wins the competitive auction. Indeed, three entirely different sets of requirements may apply in such a circumstance, contingent on the winner of the competitive auction. Such a scenario could dissuade end-users from including certain of their counterparties due solely to the unique regulatory burdens that apply.

Consider a notable example of such a problem. The European Union ("EU") has proposed that margin requirements apply to third-country nonfinancial counterparties below the clearing threshold ("NFC-s"), even while domestic NFC-s are proposed to be exempt from margin requirements. Non-EU NFC-s would likely exclude EU banks from competitive auctions on account of the margin requirements that would apply should the EU bank win the competitive auction. In this case, the absence of harmonized margin requirements would cause fragmentation in the market, inducing market participants to transact only with counterparties in their local markets in order to avoid burdensome regulatory requirements that are widely agreed as unnecessary for the mitigation of systemic risk—the outcome margin requirements are focused on achieving.

III. End-Users Have Seen Significant Effects of Inconsistent Regulations

As we have mentioned, derivatives end-users maintain global operations with their affiliates throughout the world. As a result, such affiliates or the transactions that such affiliates enter into will be subject to the rules of multiple jurisdictions, leading to significant operational and cost burdens for end-user companies.

In the area of reporting, end-users have faced significant challenges attempting to comply with duplicative and conflicting sets of rules. For example, often affiliates within a corporate group enter into internal transactions with other affiliates to shift risk management transactions to the

[1] The Consultation explains that "… many regulators conducting the assessment utilize an outcomes-based approach in that they evaluate whether and to what extent the foreign regulatory regime achieves regulatory 'outcomes' that are generally predetermined and comparable to those achieved by the domestic regulator (as opposed to focusing solely on a line-by-line comparison of the language of the rules and regulations)." Consultation at 18.

entities within the corporate group that are subject to the hedged risks. These inter-affiliate derivatives transactions do not increase systemic risk, but instead are used to manage risks more efficiently and effectively. The U.S. Commodity Futures Trading Commission ("CFTC") has recognized that there is little value in this inter-affiliate data from end-users when considering the operational and cost burdens and has accordingly issued no-action relief from its reporting rules for inter-affiliate swaps of end-users.[2] However, under the European Market Infrastructure Regulation ("EMIR"), end-users do not have such relief and are required to report inter-affiliate derivatives where one affiliate is subject to EMIR. These requirements to report internal transactions under EMIR are extremely burdensome and unnecessary.

The inconsistencies between regulations and burdens on derivatives end-users are also apparent with respect to the reporting of external swaps. Certain jurisdictions, such as the United States, have removed many of the reporting burdens from end-users by virtue of a single-sided reporting regime. However, other jurisdictions, such as the EU, have implemented a dual-sided reporting regime that requires both parties to a derivatives transaction (which has already been validated and confirmed between the parties) to report the same data to a trade repository and have in place other mechanisms to remedy transactions initially unmatched and rejected by a trade repository. Such a dual-reporting system is duplicative and unnecessary and has placed tremendous costs and operational and legal burdens on derivatives end-users. For example, let's assume that a German end-user affiliate enters into a swap with the guaranteed U.K. affiliate of a U.S. bank. That same swap would be required to have three separate transaction reports sent to trade repositories—two reports under EMIR and one report under the CFTC's regulations.

Accordingly, the Coalition supports the efforts of IOSCO to harmonize global derivatives regulations. We recommend that IOSCO continue to urge global regulators to recognize equivalency of reporting rules to allow compliance with the rules of the jurisdiction in which the corporate group is headquartered, including any relevant exemptions and no-action relief from such jurisdiction.

IV. Near-Term Harmonization Opportunity: Margin Implementation

We urge IOSCO to consider the global implementation of margin requirements as a near-term opportunity to facilitate globally harmonized financial regulations. IOSCO and the Basel Committee on Banking Supervision ("BCBS") successfully completed a series of consultations via the Working Group on Margining Requirements ("WGMR") which resulted in globally agreed margin standards. However, there has been a lag in translating these standards into domestic legal regimes such that national regulations implementing margin requirements in the G20 have yet to be finalized in any country. Additionally, countries, including the United States, have proposed regulations that depart from WGMR-agreed approaches in notable ways. For example, prudential

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[2] *See* CFTC Letter 13-09 (Apr. 5, 2013).

regulators and the CFTC have proposed to lower the threshold at which initial margin requirements apply to a level far below that agreed upon globally.[3]

We believe IOSCO can play a useful role in facilitating globally harmonized margin regulations by creating an implementation timeline that reasonably ensures that margin regulations can be implemented in the prescribed timeframe. The currently proposed implementation date for variation margin, for example, does not afford sufficient time for market participants to address the significant operational, technological and documentation burdens the margin rule would impose, especially taking into account the absence of finalized rules. We urge IOSCO to work with the BCBS and WGMR to extend the implementation date by not less than one year following the date by which regulations in the U.S. and EU finalize their rules. We also urge IOSCO to encourage countries that propose to depart from these globally agreed upon standards to finalize their rules in a manner consistent with the global agreement.

V. Increased Role for End-Users in International Dialogue

Given the broad impact that global derivatives regulations have on derivatives end-users with respect to cost, operational and legal burdens, the Coalition continues to seek ways to have the voice of derivatives end-users heard on a global basis. We very much appreciate the opportunity to comment on this Consultation and we are very appreciative of the work that IOSCO is doing to improve international harmonization. We continue to look for opportunities to provide input from a wide cross-section of end-user companies to the global harmonization efforts of IOSCO and other international working groups. For example, we are eager to offer the Coalition to serve as a resource to provide input to the Committee on Payments and Market Infrastructure ("CPMI") and IOSCO's work on monitoring implementation and data harmonization and the goal to achieve a "global data set."

VI. Conclusion

We thank the IOSCO Board for the opportunity to comment on this important Consultation. The Coalition appreciates IOSCO's efforts to harmonize global regulations to reduce duplication and burdens on global derivatives market participants, including end-users. We are available to discuss at your convenience.

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[3] We note that while nonfinancial end-users are generally exempt from margin requirements, financial end-users, including affiliates of nonfinancial end-users, could be subject to such margin requirements.

Thank you for your consideration of these very important issues to derivatives end-users. Please contact Michael Bopp at 202-955-8256 or mbopp@gibsondunn.com if you have any questions or concerns.

Yours sincerely,

Coalition for Derivatives End-Users