ČESKÁ BANKOVNÍ ASOCIACE

Set up in 1990, the Czech Banking Association (CBA) is the voice of the Czech banking sector. The CBA represents the interests of 37 banks operating in the Czech Republic: large and small, wholesale and retail institutions. The CBA is committed to supporting quality regulation and supervision and consequently the stability of the banking sector. It advocates free and fair competition and supports the banks' efforts to increase their efficiency and competitiveness.

We appreciate the opportunity to comment on Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions Second Consultative Document **MARGIN REQUIREMENTS FOR NON CENTRALLY CLEARED DERIVATIVES.**

Q1. Given the particular characteristics of physically-settled FX forwards and swaps, should they be exempted from initial margin requirements with variation margin required as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments?

We strongly believe that physically-settled FX forwards and swaps should be exempted from initial margin requirements and we strongly support this principle.

Not only physically-settled FX forwards and swaps with different maturities should be subject to different treatments. This should be a general principle applicable to every class of non-centrally cleared derivatives. In general, derivatives with shorter maturity have lower credit risk potential and they should be subject to less strict margin requirements than those with longer maturity.

Q2. Should re-hypothecation be allowed to finance/hedge customer positions if re-hypothecated customer assets are protected in a manner consistent with the key principle? Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; (ii) the pledgee treats re-hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.

Re-hypothecation should be allowed if the customer assets are sufficiently protected. We are of the opinion that the proposed principles (i.e. collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; the pledgee treats re-hypothecated collateral as customer assets; and the applicable insolvency regime allows customer first priority claim over the pledged collateral) sufficiently protect the customer assets.

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Q3. Are the proposed phase-in arrangements appropriate? Do they appropriately trade off the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements? Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?

We suppose that the proposed phase-in arrangements are too strict.

We strongly support the idea that the gradual phase-in arrangements should not apply only to the exchange of initial margin, but the same or at least similar phase-in arrangements should also apply to the exchange of variation margin. Exchange of variation margin has not been a widely-adopted market practice yet. Immediate implementation of the variation margin requirements would cause unforeseen liquidity problems for the market participants.

We are of the opinion that the period for the implementation of both initial and variation margin requirements should last at least 10 years and the phase-in arrangements should be spread out for this minimum 10 years period. In case of emerging markets this period should be even further prolonged.

We support the principle that the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage, and the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements.

We also strongly believe that the requirements to exchange margin should apply only if both parties of the transaction exceed the defined thresholds.

We also believe that the calculation of the thresholds applicable within the phase-in arrangements should be based on the exposures of the parties, rather than on the notional amounts of derivatives, because the notional amount itself does not represent any real exposure and it may not be a reasonable basis for any calculation of credit risk exposures.

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Q4. The BCBS and IOSCO seek comment on the accuracy and applicability of the QIS results discussed above.

We have no specific opinion.

We hope that our response to BCBS and IOSCO consultative document is sufficiently clear and our views are helpful for preparing the margin requirements.

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