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MARGIN REQUIREMENTS FOR NON-CENTRALLY-CLEARED DERIVATIVES

Consultative Document

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Federcasse, the *Italian Federation of Credit Cooperative Banks*, would like to thank the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions for the opportunity to share its views on the important consultation on Margin requirements for non-centrally-cleared derivatives.

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Implementation and timing of margin requirements

Q1. What is an appropriate phase-in period for the implementation of margining requirements on non-centrally-cleared derivatives? Can the implementation timeline be set independently from other related regulatory initiatives (eg central clearing mandates) or should they be coordinated? If coordination is desirable, how should this be achieved?

We consider worthwhile to contemplate a phase-in period – at least 6/12 months – in order to update the agreements with the counterparties and to make operating the exchange of the collateral. Besides, the period of implementation should be properly coordinated regarding the capital requirements (Basel III and CRD IV), in particular providing for a capital absorption greater for non-centrally cleared derivatives just at the end of the mentioned phase-in period.

Element 1: Scope of coverage – instruments subject to the requirements

Q.2 Should foreign exchange swaps and forwards with a maturity of less than a specified tenor such as one month or one year be exempted from margining requirements due to their risk profile, market infrastructure, or other factors? Are there any other arguments to support an exemption for foreign exchange swaps and forwards?

We deem reasonable that FX swaps and forwards transactions should be subject to margin requirements. However, in order to determine the initial margin, we suggest to distinguish the relevant percentage according to the duration of the transaction.

Q3. Are there additional specific product exemptions, or criteria for determining such exemptions, that should be considered? How would such exemptions or criteria be

consistent with the overall goal of limiting systemic risk and not providing incentives for regulatory arbitrage?

We deem necessary to exclude from the scope of margin requirements the hedging derivatives. Otherwise financial firms (and not) could be discouraged to carry out transactions for an efficient risk management. As an alternative, we might consider the provision of a CSA "one way", where the obligation of collateralization must be fulfilled by the counterpart with which the derivative contract for hedging purposes has been put in place (see Q6).
An additional exemption should be set for derivatives transactions put in place within securitization in which the purpose of the derivative contract is only to regulate the cash flows at the same deadline.

Element 2: Scope of coverage – scope of applicability

Q4. Is the proposed key principle and proposed requirement for scope of applicability appropriate? Does it appropriately balance the policy goals of reducing systemic risk, promoting central clearing, and limiting liquidity impact? Are there any specific adjustments that would more appropriately balance these goals? Does the proposal pose or exacerbate systemic risks? Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

Firstly, regarding the percentages contained in the consultative document, we would like to point out the necessity of establish provisions consistent with the requirements provided by Basel II. On this point, we suggest, in order to quantify the initial margin, the application of percentage which take into account the duration and the type of derivative. Besides, we believe necessary to define the discretion, for a creditor, to accept financial instruments issued by itself in order to guarantee its credit positions.

Q5. Are initial margin thresholds an appropriate tool for managing the liquidity impact of the proposed requirements? What level of initial margin threshold(s) would be effective in managing liquidity costs while, at the same time, not resulting in an unacceptable level of systemic risk or inconsistency with central clearing mandates? Is the use of thresholds inconsistent with the underlying goals of the margin requirements? Would the use of thresholds result in a significant amount of regulatory arbitrage or avoidance? If so, are there steps that can be taken to prevent or limit this possibility?

The initial margin threshold is an appropriate instrument for the mitigation of the liquidity risk mainly for the large entities because it is usually linked to the rating or assets. Therefore, we suggest the introduction of a principle of proportionality, eliminating any discretion in favor of the counterparties.

Q6. Is it appropriate for initial margin thresholds to differ across entities that are subject to the requirements? If so, what specific triggers would be used to determine if a smaller or zero threshold should apply to certain parties to a non-centrally-cleared derivative? Would the use of thresholds result in an unlevel playing field among market participants? Should the systemic risk posed by an entity be considered a primary factor? What other factors should also be considered? Can an entity's systemic risk level be meaningfully measured in a

transparent fashion? Can systemic risk be measured or proxied by an entity's status in certain regulatory schemes, eg G-SIFIs, or by the level of an entity's non-centrally-cleared derivatives activities? Could data on an entity's derivative activities (eg notional amounts outstanding) be used to effectively determine an entity's systemic risk level?

We consider appropriate to distinguish the initial margin according to the purpose of the derivative (for example trading or hedging, see Q3)

Q7. Is it appropriate to limit the use of initial margin thresholds to entities that are prudentially regulated, ie those that are subject to specific regulatory capital requirements and direct supervision? Are there other entities that should be considered together with prudentially-regulated entities? If so, what are they and on what basis should they be considered together with prudentially-regulated entities?

We consider appropriate to restrict the use of the initial margin threshold for prudentially regulated entities compared to other entities.

Q8. How should thresholds be evaluated and specified? Should thresholds be evaluated relative to the initial margin requirement of an approved internal or third party model or should they be evaluated with respect to simpler and more transparent measures, such as the proposed standardised initial margin amounts?10 Are there other methods for evaluating thresholds that should be considered? If so what are they and how would they work in practice?

With reference to the method to calculate the initial margin, we think preferable a simplified model. Therefore the counterparties should have the faculty to adopt a more sophisticated model. Moreover, we think should be allowed to perform the calculation activity in outsourcing providing that, in cases of conflicts of interests, the outsourcer ensures suitable controls.

Q9. What are the potential practical effects of requiring universal two-way margin on the capital and liquidity position, or the financial health generally, of market participants, such as key market participants, prudentially-regulated entities and non-prudentially regulated entities? How would universal two-way margining alter current market practices and conventions with respect to collateralising credit exposures arising from OTC derivatives? Are there practical or operational issues with respect to universal two-way margining?

On this point we believe that the obligation of the bilateral collateralization contrasts with the principle of proportionality, having regards to the dimension of the entities involved in the transaction. In any case, we suggest to refer to the possible solutions provided on Q3 and Q11.

Q10. What are the potential practical effects of requiring regulated entities (such as securities firms or banks) to post initial margin to unregulated counterparties in a non-centrally-cleared derivative transaction? Does this specific requirement reduce, create, or exacerbate systemic risks? Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

We believe that the obligation for the prudentially regulated entities to post initial margin to unregulated counterparties increases systemic risk.

Q12. Are there any specific exemptions that would not compromise the goal of reducing systemic risk and promoting central clearing that should be considered? If so, what would be the specific exemptions and why should they be considered?

As regards to the article 3, paragraph 2, letter b) of EMIR Regulation, the intragroup transactions should be exempted from the collateralization. In particular, it is considered necessary to provide the exemption, from the obligation of collateralization, for members of the same Institutional Protection Scheme (IPS) under the article 80 (8) of the 2006/48/CE Directive. Furthermore, we believe appropriate to extend the exemption to the non-systematically important financial counterparties as well. This in application of a general principle of proportionality, otherwise the costs of collateralization – proportionally – would burden mainly on the small entities. To this end, it could be identified a certain threshold according to the supervisory capital of the entities that have entered into the transaction.

Element 4: Eligible collateral for margin

Q20. Is the scope of proposed eligible collateral appropriate? If not, what alternative approach to eligible collateral would be preferable, and why?

In order to set the eligible collateral, we believe suitable to refer to the national supervisors, taking into account as target the harmonization at EU level. Furthermore, we suggest to provide a collateral list widest possible.

Q21. Should concrete diversification requirements, such as concentration limits, be included as a condition of collateral eligibility? If so, what types of specific requirements would be effective? Are the standardised haircuts prescribed in the proposed standardised haircut schedule sufficiently conservative? Are they appropriately risk sensitive? Are they appropriate in light of their potential liquidity impact? Are there additional assets that should be considered in the schedule of standardised haircuts?

It would be preferable to use the same haircuts applied by ECB.

Element 5: Treatment of provided margin

Q22. Are the proposed requirements with respect to the treatment of provided margin appropriate? If not, what alternative approach would be preferable, and why? Should the margin requirements provide greater specificity with respect to how margin must be protected? Is the proposed key principle and proposed requirement adequate to protect and preserve the utility of margin as a loss mitigants in all cases?

We believe that initial margin can be reused with international structures for the purposes of the management and optimization of the liquidity profiles of a bank. We suggest, also, to eliminate

the possibility to post the collateral with a third party custodian in line with the market practices of the Euro area.

Q23. Is the requirement that initial margin be exchanged on a gross, rather than net basis, appropriate? Would the requirement result in large amounts of initial margin being held by a potentially small number of custodian banks and thus creating concentration risk?

We believe that the exchange of initial margin has to be made on a net basis.

Q24. Should collateral be allowed to be re-hypothecated or re-used by the collecting party? Are there circumstances and conditions, such as requiring the pledgee to segregate the re-hypothecated assets from its proprietary assets and treating the assets as customer assets, and/or ensuring that the insolvency regime provides the pledger with a first priority claim on the assets that are re-hypothecated in the event of a pledgee's bankruptcy, under which re-hypothecation could be permitted without in any way compromising the full integrity and purpose of the key principle? What would be the systemic risk consequences of allowing re-hypothecation or re-use?

See Q22.

Element 6: Treatment of transactions with affiliates

Q25. Are the proposed requirements with respect to the treatment of non-centrally-cleared derivatives between affiliated entities appropriate? If not, what alternative approach would be preferable, and why? Would giving local supervisors discretion in determining the initial margin requirements for non-centrally-cleared derivatives between affiliated entities result in international inconsistencies that would lead to regulatory arbitrage and unlevel playing field?

See Q12.