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RE: Margin and Capital Requirements for Covered Swap Entities

Ladies and Gentlemen:

We write to follow-up on the comment letters filed by The Clearing House Association L.L.C. (“TCH”), the American Bankers Association (“ABA”), and the ABA Securities Association (“ABASA”), and the Securities Industry and Financial Markets Association (“SIFMA”)¹ on the proposed rule entitled *Margin*

¹ Descriptions of the Associations can be found in Annex B.

and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. 57,348 (Sept. 24, 2014) (the “Proposed Rule”)² issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration (collectively, the “Agencies”), in consultation with the Commodity Futures Trading Commission and the Securities and Exchange Commission, which implements sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act³ (the “Dodd-Frank Act”). We are submitting the attached supplemental information describing recommended modifications to the initial margin requirements in the Proposed Rule in the context of inter-affiliate swaps (Annex A). Our comments focus solely on initial margin requirements, and do not address the proposed application of *variation margin* to inter-affiliate swaps.

As the Associations have previously stated in their written comments, we strongly believe that the imposition of initial margin requirements on inter-affiliate swap transactions not only is unnecessary as a statutory matter but is also likely to result in negative unintended consequences that are detrimental to both institutional safety and soundness and systemic financial stability. We also note that, to the extent that the Agencies perceive risks relating specifically to inter-affiliate swaps, initial margin requirements are not necessary because there are numerous other and better-suited tools currently available to the Agencies to monitor those transactions and address any related concerns, including, with respect to bank-affiliate swaps, sections 23A and 23B of the Federal Reserve Act. In this regard, we continue to believe that sections 23A and 23B, which impose significant and restrictive quantitative limits and qualitative requirements on bank-affiliate transactions, including swaps, represent Congress’s considered view of the regime to which swaps between a bank and its affiliates should be subject. Further, we are concerned that the initial margin requirements that would apply to such swaps under the Proposed Rule could unnecessarily introduce inconsistency with the letter and spirit of sections 23A and 23B. Finally, we also believe that the proposed requirements would impose costs that far outweigh their benefits, including costs to banking organizations’ safety and soundness and the safety and soundness of the financial system.

We offer the attached modifications to the Proposed Rule, which are designed to (i) ensure consistency with sections 731 and 764 of the Dodd-Frank Act and sections 23A and 23B, (ii) support safety and soundness, and (iii) satisfy each of the following policy objectives:

- Prevent evasion of margin requirements (especially in the cross-border context);
- Avoid undue incentives for additional inter-affiliate swaps (relative to third-party swaps); and
- Preserve liquidity in capital markets.

Absent our recommended modifications, we are concerned that the proposed inter-affiliate initial margin requirements would interfere with the ability of Covered Swap Entities to manage their risks on a centralized, group-wide basis, reduce available liquidity for clients (including non-financial end users), and either increase interconnectedness by requiring firms to increase trading with third parties and their

² The Proposed Rule would establish initial and variation margin requirements and capital requirements for all non-cleared swaps and non-cleared security-based swaps for registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants (each, a “Covered Swap Entity”) for which one of the Agencies is the “prudential regulator,” as defined by the Commodity Exchange Act and the Securities Exchange Act of 1934, as amended.

³ *Codified at* 7 U.S.C. § 6s(e)(2)(A)(ii) and 15 U.S.C. § 78o-10(e)(2)(A)(ii).

exposure to central counterparties (“CCPs”) or further decrease market liquidity if firms choose to scale back derivatives activity. By discouraging trades *whose purpose is risk and compliance management*, the proposal would incentivize banks to alter their behavior in a manner that would impair safety and soundness and increase systemic risk.

A. Inter-Affiliate Swaps Are Necessary for Banking Organizations to Maintain a Centralized Risk Management Function

Inter-affiliate trades do not increase the amount of risk being taken by a firm. Rather, they allow the firm to manage risk more effectively and in compliance with relevant regulations. Inter-affiliate transactions enable customers to recognize the netting benefits of engaging in transactions with a single entity of their choice. As a risk management matter, inter-affiliate trades allow a firm to match offsetting risk exposures existing within the group before hedging the net risk with third parties. Inter-affiliate swaps permit a banking organization to match offsetting risk exposures existing within the group before hedging the net risk with third parties and CCPs. Because the risk is netted and consolidated, these risk-transfer trades allow the firm to operate with less counterparty and operational risk than it would if it faced multiple counterparties through multiple affiliates. Inter-affiliate swaps also permit a banking organization to use its most expert trading and risk management personnel to manage any residual directional market risks.

Further, many local laws (including local licensing requirements) require banking organizations to operate through local subsidiaries or affiliates. Banking organizations also frequently issue debt securities from their holding companies. In these circumstances, inter-affiliate swaps allow banking organizations to meet client demand and funding needs while appropriately allocating the resulting risks to the affiliate with the personnel, infrastructure, and expertise to manage them centrally and effectively.

For resolution purposes, regulators have generally indicated that it is preferable for a top tier holding company to hedge its risks with its affiliates rather than to engage in transactions with third parties. While the ISDA Resolution Stay Protocol and follow-on regulations would prevent a derivatives close-out by third parties at the subsidiary level based on a holding company bankruptcy or receivership, in cases in which a holding company is in direct default with external counterparties, the protocol would not prevent close-out of the holding company’s transactions. Accordingly, regulators have also indicated that it is preferable for organizations to limit swaps transactions between a parent holding company and third parties in order to limit possible contagion risks and knock-on effects that might occur upon the default of the holding company.

B. A Two-Way Inter-Affiliate Initial Margin Requirement Would Create Significant Commercial Obstacles to Using Inter-Affiliate Swaps and Lead Banks to Pursue Alternatives that Would Impair Their Safety and Soundness and Increase Systemic Risk

Banking organizations use inter-affiliate swaps almost exclusively to ensure the proper internal allocation of risks arising from outward-facing transactions. The additional costs of funding and segregating⁴ the proposed level of initial margin for inter-affiliate swaps would generally exceed the net revenues or net funding efficiencies of the related outward-facing transactions, which would likely result in the following negative impacts to the safety and soundness of banks and the financial system:

⁴ We observe that applying a third-party custody requirement to inter-affiliate swaps would increase operational and custodial risk and raises questions about the treatment of this third-party custody requirement under section 23A.

- **Increased Interconnectedness and CCP Exposure.** Imposing two-way initial margin requirements on inter-affiliate swaps would likely make clearing those swaps or trading uncleared swaps with third parties preferred commercial alternatives, as executing an equivalent inter-affiliate swap would require a banking organization to more than double the amount of initial margin that it would have to segregate on a consolidated basis. This increase would be due primarily to the obligation to post and segregate initial margin for both sides of the swap (as opposed to posting initial margin solely to the CCP or a counterparty, for one side of the swap). Another factor that would make clearing inter-affiliate swaps a preferred commercial alternative for risks that can be hedged with cleared products is that, under the Proposed Rule, leaving those swaps uncleared would require a banking organization to post and segregate initial margin computed using a ten-day liquidation horizon (as opposed to the five-day liquidation horizon typically used to compute initial margin for cleared swaps).⁵
 - For risks that can be hedged with cleared products, banks would likely choose to hedge using such clearable products. However, incentivizing firms to convert *affiliate* credit risk related to internal risk management trades to *CCP* credit risk, rather than allowing firms to prudently manage their exposure to CCPs, would unnecessarily increase the exposure of many banking organizations to CCPs. Both domestic and international regulators are growing increasingly concerned about the extent of banks' and the financial system's exposure to, and interconnectedness through, CCPs.
 - Similarly, for risks that may not be able to be hedged with cleared products, inter-affiliate swaps are likely to be replaced with third-party swaps, which will unnecessarily increase the interconnectedness of financial firms and markets, thereby increasing the risk exposures of financial firms to one another.
- **Decentralized Risk-Management.** Banks may be compelled to decentralize their risk management functions, resulting in the retention of increased risk throughout the organization in various local entities and the use of less expert personnel operating outside of the region and time zone of the relevant hedging market. Though those risks that would be managed locally would still be subject to the firm's internal limits, banks may need to leave some risks less than perfectly hedged at the local legal entity level because of the loss of the netting efficiencies of centralized risk management, increasing the risk exposures of those entities.
- **Reduced Market Liquidity.** Because inter-affiliate trades would become less economically viable, banks may stop providing some products to certain markets or clients, such as products relied on by corporations and pension plans to hedge their exposures in markets that the bank can only access through a local affiliate. If they continue to provide such products, banks also may build the increased costs of a two-way inter-affiliate initial margin requirement into pricing structures. These changes could negatively impact non-financial end users who are not intended to be so impacted by the Proposed Rule.

Further, the cumulative effect of an inter-affiliate initial margin requirement combined with other regulatory requirements applicable to third-party and cleared swaps may also impair liquidity in certain markets. Indeed, as referenced in the TCH-ABA-ABASA 2014 comment letter, the Basel

⁵ Further, an inter-affiliate initial margin requirement would essentially vitiate the exemption from mandatory clearing issued by the CFTC by incentivizing banks to, nevertheless, clear those trades. See CFTC, *Clearing Exemption for Swaps Between Certain Affiliated Entities* (Apr. 11, 2013), 78 Fed. Reg. 21750, codified at 17 C.F.R. § 50.52.

Committee on Banking Supervision and Board of the International Organization of Securities Commissions “cautions that the potential benefits of margin requirements must be weighed against the liquidity impact and must also be considered in the context of the ‘ongoing and parallel regulatory initiatives that will also have significant liquidity impacts....’”⁶ In particular, the U.S. Supplemental Leverage Ratio and proposed G-SIB surcharge impose high capital charges regardless of whether margin is collected. These capital charges could lead either to the trapping of liquidity in the form of those higher capital requirements for banks’ increased third-party and cleared trades or may in fact lead dealers to retrench their trading activities in certain markets to avoid those requirements.⁷

- **Increased Systemic Risk.** Requiring inter-affiliate initial margin, and thereby significantly discouraging inter-affiliate trades as uneconomic, could also result in greater systemic risk. Consider a holding company with two subsidiaries, with Subsidiary A long the market and Subsidiary B short the market, and the consolidated firm thus net flat the market. If both subsidiaries post initial margin to third parties (whether bilateral or cleared at a CCP), those positions can be closed out in the event of perceived weakness of the organization, thereby eroding capital of the affected subsidiaries. If inter-affiliate trades were not discouraged via inter-affiliate two-way initial margin, less margin would be outstanding to third parties and capital of banks could be preserved. Indeed, preserving capital at the legal entity level is a key component of making closeouts more predictable, less volatile, and thus less disruptive.

C. Inter-Affiliate Initial Margin Requirements Are Largely Irrelevant in an SPOE Resolution

Inter-affiliate initial margin does not facilitate a more orderly or successful single-point-of-entry (“SPOE”) resolution strategy, which is particularly noteworthy given that SPOE is likely to be U.S. financial regulators’ preferred approach to resolution of large, complex U.S. banking organizations under either a Title I bankruptcy or a Title II Orderly Liquidation Authority resolution. SPOE resolution contemplates the failure of the parent holding company coupled with the continued operation and solvency of all material subsidiaries, and thus does not contemplate the immediate close out of internal risk management trades between such subsidiaries. Therefore, two-way inter-affiliate initial margin between surviving affiliates would likely be largely irrelevant in an SPOE resolution scenario. In this regard, the viability and efficacy of an SPOE resolution regime is in no way dependent on a requirement for two-way inter-affiliate initial margin.

⁶ See TCH-ABA-ABASA Comment Letter re: *Margin and Capital Requirements for Covered Swap Entities*, dated November 24, 2014, citing Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, *Margin Requirements for Non-Centrally Cleared Derivatives*, Sept. 2013, at 3, available at <http://www.bis.org/publ/bcbs261.pdf>.

⁷ These concerns may be more significant for markets in the United States, where a more stringent supplementary leverage ratio and G-SIB surcharge have been implemented (and an NSFR requirement is expected) that are likely to exacerbate these concerns relative to foreign markets. Thus, it would be inapposite if the U.S. were the only country to choose *not* to exempt inter-affiliate trades from initial margin. We understand that Japan’s proposal would exempt inter-affiliate trades from initial margin requirements and that the European Union’s proposal would defer to local jurisdictions on the issue of inter-affiliate initial margin, and that those local jurisdictions, such as the United Kingdom and Germany, are favorably inclined to exempt inter-affiliate trades from an initial margin requirement, including those between registered Swap Dealers.

D. The Agencies Should Modify Inter-Affiliate Initial Margin Requirements in a Manner that is Consistent with Underlying Statutory Policies and Safety and Soundness Objectives

As noted above, the attached recommended modifications to an inter-affiliate initial margin requirement are designed to address the same concerns that the Proposed Rule was intended to address in a manner that is consistent with the relevant statutes, policy considerations, and safety and soundness objectives. We look forward to working with the Agencies as they consider the proposal in Annex A.

E. The Agencies Should Provide a Sufficient Conformance Period After the Effective Date of Any Inter-Affiliate Initial Margin Requirement

Finally, because any inter-affiliate initial margin requirement would require banking organizations to significantly alter their risk management architectures and related infrastructure, we respectfully request that the Agencies provide a conformance period of sufficient duration after the effective date of any such requirement, to enable firms to undertake these substantial changes in a manner that minimizes the negative impact on the firm's safety and soundness to the extent possible.

If you have any questions or need further information, please contact John Court at (202) 649-4628 (email: john.court@theclearinghouse.org), Cecelia Calaby at (202) 663-5325 (email: ccalaby@aba.com), or Kyle Brandon at (212) 313-1280 (email: kbrandon@sifma.org).

Respectfully submitted,



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Proposed Modifications to Inter-Affiliate Initial Margin Requirements⁸

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
<p><u>Issue 1: Two-Way Initial Margin Requirements.</u> From the corporate group’s perspective, two-way initial margin requirements between affiliates by definition would require <u>twice</u> the amount of segregated margin as an equivalent third-party transaction. This significant amount of extra collateral is far more than would be necessary to address the risks of inter-affiliate swaps and would create undesirable incentives for a Swap Entity to trade with third parties or to unnecessarily increase its volume of cleared transactions. The third-party segregation requirement associated with two-way initial margin requirements may also present an obstacle to the ability of an insured depository institution (“IDI”) to count initial margin from affiliates toward reducing bank-affiliate “credit exposure” for purposes of section 23A (or counting section 23A cash collateral toward satisfaction of initial margin requirements).</p>	<p><u>Alternative A – Categorization of Affiliates.</u> These undesirable incentives would be addressed best by modifying the inter-affiliate initial margin requirement to take into account the different risks and policy objectives relevant to different combinations of affiliates:</p> <p><u>Swap Entity vs. Less Regulated Affiliate – One Way in Favor of the Swap Entity.</u> Instead of each Swap Entity posting <u>and</u> collecting segregated initial margin to/from its affiliate, the Swap Entity would <u>only</u> collect from its affiliate (subject to a wholly owned subsidiary exemption (addressed under Issue #2) and a de minimis exemption (addressed under Issue #4), both of which are set out further below). The Swap Entity would be permitted to segregate the initial margin within its group, so as to prevent undue third-party custodial risk.</p> <p><u>For example:</u></p> <ul style="list-style-type: none"> • U.S. swap dealer (“SD”) (IDI) vs. unregulated, holding company chain Asia risk management affiliate – one way IM in favor of the U.S. SD (IDI) 	<p>A one-way initial margin requirement would equalize the group-wide liquidity need for inter-affiliate swaps with that of swaps with a third party, as well as protect the safety and soundness of the Swap Entity.</p> <p>If the Swap Entity is an IDI subject to section 23A, this one-way initial margin should reduce the amount of any credit exposure under section 23A (similarly, section 23A cash collateral deposited with the IDI by an affiliate for purposes of section 23A should satisfy this one-way initial margin requirement).</p> <p>In a resolution scenario, a one-way initial margin requirement would ensure the presence of sufficient resources to protect Swap Entities from potential inter-affiliate shortfalls, consistent with the purposes of the statute.</p>

⁸ Under these recommendations, full two-way variation margin requirements would continue to apply to inter-affiliate swaps as proposed.

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
	<p>would be required. (Note, the requirements of section 23A would continue to apply to transactions between the IDI and its affiliates, including the Asia risk management affiliate in this case.)</p> <ul style="list-style-type: none"> • U.S. SD (non-IDI) vs. unregulated, holding company chain Latin American risk management affiliate – one way IM in favor of the U.S. SD would be required. <p><u>Swap Entity vs. Highly Regulated Affiliate – Initial Margin Exception.</u> To further avoid undesirable incentives for increased trading with third parties or through CCPs, and in recognition of the significantly reduced risk posed by a counterparty to a Swap Entity that is subject to rigorous capital and margin requirements, such swaps should benefit from an exception to initial margin requirements.</p> <p><u>For example:</u></p> <ul style="list-style-type: none"> • U.S. SD (IDI) vs. regulated U.S. BHC (both affiliates are subject to Basel capital, and any external trades are fully subject to U.S. OTC margin rules) –no IM would be required to be posted by either party. (Note, the requirements of section 23A would continue to apply to transactions between the IDI and its affiliates, including the BHC affiliate in this case). 	<p></p> <p>To reduce the risks to the Swap Entity and potential for evasion, this exception would be limited to uncleared swaps between a Swap Entity and an affiliate that is a:</p> <p>(i) U.S. or non-U.S. Swap Entity subject to U.S. capital rules (at the entity level) and U.S. margin rules, or Basel-compliant capital requirements and BCBS/IOSCO-compliant margin requirements (e.g., EU; Japan; etc.); or</p> <p>(ii) U.S. or non-U.S. entity subject to Basel-compliant capital requirements (at the entity-level) and BCBS/IOSCO-compliant margin requirements.</p> <p>The requirements of section 23A would continue to apply to any transaction involving an IDI, notwithstanding this exception, thus ensuring that in a resolution scenario, an IDI Swap Entity would be protected from any inter-affiliate shortfalls.</p>

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
	<ul style="list-style-type: none"> • U.S. SD (IDI) vs. holding company chain regulated non-U.S. SD affiliate (e.g., U.K. broker dealer/Swap Dealer) (both affiliates are subject to Basel capital, and all third party trades for both are fully subject to U.S. OTC margin rules or their equivalent) – hence, no IM would be required to be posted by either party. • The banking organization has received and is holding IM posted from the client, which it uses to mitigate credit risk at the client facing entity. Client IM posted can be used by the banking organization upon the default of a client to offset risk/costs incurred related to the internal hedging or replacement of such trades. (Note, the requirements of section 23A would continue to apply to transactions between the IDI and its affiliates, including the UK broker dealer/Swap Dealer affiliate in this case.) 	<p>Although non-IDI Swap Entities could face inter-affiliate shortfalls, the highly regulated nature of the relevant affiliates would significantly reduce the likelihood of a default, and the continued presence of full variation margin would reduce the size of any potential shortfall.</p>

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
	<p><u>Alternative B – Segregated Counterparty Pair Initial Margin Accounts.</u> To the extent that, notwithstanding the preceding proposal, the Agencies determine that initial margin is necessary, or a one-way initial margin requirement is not adequate, then at a minimum, the Agencies should permit the common parent of an affiliate pair to post a single amount of segregated initial margin in which each affiliate would have a security interest.⁹ These amounts would be segregated in a custody account of the IDI counterparty (if applicable) or Swap Entity (if applicable and the counterparty is not an IDI).</p> <p>This proposal is conditional on an IDI’s ability to rely on it to satisfy section 23A requirements in addition to initial margin requirements. For example, an IDI should be able to reduce the amount of any credit exposure under section 23A by the amount of initial margin so long as (a) the initial margin is held in a custody account at the IDI, and (b) the IDI has a first priority perfected security</p>	<p>This alternative approach recognizes that, because of netting, both affiliates in a pair cannot simultaneously default with each owing money to the other.</p> <p>Two-way initial margin requirements would not be necessary to promote central clearing (because inter-affiliate swaps are exempt from mandatory clearing) or to ensure that the defaulter pays (because the initial margin would be funded by a common parent company, which is indifferent to which affiliate’s portfolio is in the money).</p>

⁹ In the context of a group in which there are a multiplicity of covered inter-affiliate portfolios, this pool of initial margin could be shared among all the covered affiliates, with the amount of initial margin in the common pool equal to the maximum potential net replacement costs (calculated using the relevant initial margin calculation standards) that non-defaulting affiliates could, in the aggregate, face under the worst case possible combination of affiliate defaults. For example, if a subset of affiliate A’s swaps with affiliate B were offset by swaps between affiliate B and affiliate C, then in B’s default it would be less costly and disruptive for A and C to replace their swaps with B by entering into swaps with each other at the prevailing mid-market level than to enter into those swaps with third parties. As a result, if a default by B (with A and C surviving) was the worst case affiliate default scenario, then the inter-affiliate initial margin pool would be equal to the sum of A’s estimated potential future exposure to B and C’s estimated potential future exposure to B, reduced by the exposures arising from A’s and C’s swaps with B that are offset by each other.

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
	interest in the initial margin (the other affiliate would have a junior security interest).	

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
<p><u>Issue 2: Wholly-Owned Subsidiaries of Swap Entities.</u> From the Swap Entity’s perspective, two-way initial margin requirements between the Swap Entity and its wholly-owned subsidiary would require the Swap Entity to fund <u>twice</u> the amount of segregated margin as an equivalent third-party transaction by its subsidiary. This significant amount of extra collateral is far more than would be necessary to address the risks of Swap Entity-subsidary swaps and would create undesirable incentives for a Swap Entity’s subsidiaries to trade with third parties or to unnecessarily increase their volume of cleared transactions.</p> <p>Further, subsidiaries of banks (that are not themselves banks) are generally not treated as “affiliates” under sections 23A and 23B, reflecting Congress’s determination that bank-subsidary transactions do not pose the risks to the IDI that sections 23A and 23B were designed to address. Imposing a two-way initial margin requirement on Swap Entity-subsidary swaps risks unnecessarily introducing inconsistencies with sections 23A and 23B.</p>	<p><u>Swap Entity vs. Wholly-Owned Direct or Indirect Subsidiary – Initial Margin Exception.</u> To avoid undesirable incentives for increased trading with third parties or through CCPs, and in recognition of the significantly reduced risk posed by a wholly-owned direct or indirect subsidiary to a Swap Entity, such swaps should benefit from an exception to initial margin requirements.</p> <p><u>For example:</u></p> <ul style="list-style-type: none"> • U.S. SD (IDI) vs. non-SD U.S. mortgage subsidiary (e.g., OCC Part 5 operating subsidiary), or non-SD Edge Act subsidiary (Regulation K, Part 211) – no IM would be required to be posted by the IDI in connection with swaps entered into with either subsidiary. • U.S. SD (IDI) vs. SD Edge Act subsidiary fully subject to Basel capital and U.S. (or equivalent) OTC margin rules (e.g., Regulation K U.K. BD/SD) – no IM would be required to be posted by either party. (Note, this trading pair would have also qualified for the above proposed SD vs. Highly Regulated Affiliate exception described above, as the SD Edge Act subsidiary must be fully subject to Basel capital and U.S. (or equivalent) OTC margin rules for all external trades.) 	<p>Capital and risk management requirements applicable to Swap Entities generally take into account the risks posed to a Swap Entity by the activities of its subsidiaries.</p> <p>Further, this modification would be consistent with Congress’s determination that bank-subsidary transactions do not pose the risks to the insured depository institution that sections 23A and 23B were designed to address.</p>

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
<p><u>Issue 3: Liquidation Horizon.</u> The significant majority of inter-affiliate swaps are clearable (but exempt from mandatory clearing), meaning that an equivalent third-party swap would be cleared and margined using a <u>5-day</u> liquidation horizon, instead of <u>10 days</u>.</p>	<p><u>Appropriate Liquidation Horizon.</u> Instead of a 10-day liquidation horizon, initial margin for an inter-affiliate portfolio should be calculated using a 5-day liquidation horizon.</p>	<p>This modification reflects the fact that inter-affiliate swaps are subject to group-wide risk management and common risk and pricing models that provide for transparency and close-out efficiencies not present in the context of swaps with third parties, and the avoidance of delays resulting from third-party disputes.</p> <p>This modification would also help align the initial margin amount for most inter-affiliate swaps to comparable cleared swaps with third parties, so as to not effectively push firms to increase their exposure to CCPs by clearing inter-affiliate swaps.</p>
<p><u>Issue 4: Initial Margin Threshold.</u> Because it is drafted to apply to swaps between unaffiliated consolidated groups, the \$65 million initial margin threshold is not tailored to apply in the inter-affiliate context.</p>	<p><u>Limitation for Inter-Affiliate Swaps.</u> The proposed \$65 million initial margin threshold should apply to each inter-affiliate pair involving a Swap Entity, subject to an aggregate limit of 5 percent of a Swap Entity's aggregate inter-affiliate notional volume in uncleared swaps. As in the case of swaps with a third party, swaps between a Swap Entity and an affiliate that give rise to a potential future exposure below this threshold would not be subject to initial margin requirements.</p> <p><u>For example:</u></p> <ul style="list-style-type: none"> U.S. SD (IDI) vs. non-SD holding company chain Indian affiliate where (i) the volume of inter-affiliate derivatives for this pair is below 5% of the U.S. SD's aggregate inter-affiliate notional volume in uncleared swaps, <u>AND</u> (ii) the uncollateralized PFE of U.S. SD to the 	<p>Given the presence of common control and group-wide risk management, Swap Entities are in a better position to manage their uncollateralized potential future exposure to affiliates than third parties.</p> <p>At the same time, applying a 5 percent notional volume limitation to reliance on the initial margin threshold would ensure that only a <i>de minimis</i> portion of the Swap Entity's inter-affiliate volume is conducted in reliance on the threshold.</p> <p>This threshold is necessary in order for Swap Entities to manage their risk in asset categories where they may only access local markets through local affiliates.</p>

<i>Issue</i>	<i>Proposal</i>	<i>Discussion</i>
	non-SD Indian affiliate is below \$65mm -- no IM would be required to be posted by either party. (Note, the requirements of section 23A would continue to apply to transactions between the IDI and its affiliates, including the Indian affiliate in this case).	
<u>Issue 5: Implementation Schedule for Inter-Affiliate Initial Margin Requirements.</u> Any inter-affiliate initial margin requirement would require banking organizations to significantly alter their risk management frameworks and related infrastructure.	<u>Appropriate Conformance Period.</u> There should be a conformance period of sufficient duration after the effective date of any such inter-affiliate initial margin requirement to enable firms to undertake the necessary changes. The appropriate duration of the conformance period would depend on the scope and nature of any inter-affiliate initial margin requirement.	A conformance period of appropriately-calibrated duration will enable banking organizations to make necessary modifications to their risk management frameworks and infrastructure in a manner that minimizes the potential negative impact on safety and soundness.

The Associations

The Clearing House

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost \$2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

Securities Industry and Financial Markets Association

SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

American Bankers Association

The American Bankers Association is the voice of the nation's \$15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits and extend more than \$8 trillion in loans.

ABA Securities Association

ABA Securities Association is a separately chartered affiliate of the American Bankers Association, representing those holding company members of the American Bankers Association that are actively engaged in capital markets, investment banking, swap dealer and broker-dealer activities.