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July 9, 2015

*Via European Banking Authority Portal*

European Banking Authority  
European Insurance and Occupational Pensions Authority  
European Securities and Markets Authority

Re: *Second Consultation Paper: Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP*

Dear Sir or Madam:

ICI Global<sup>1</sup> appreciates the opportunity to provide comments on the second consultation paper issued by the European Securities and Markets Authority (“ESMA”), the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively “European Supervisory Authorities” or “ESAs”) on draft regulatory technical standards (“RTS”) for margin requirements for non-centrally cleared OTC derivatives.<sup>2</sup> Under the European Market Infrastructure Regulation (“EMIR”), the ESAs are mandated to develop standards on specific aspects of the margin framework for non-centrally cleared OTC derivatives.

The ESAs published their initial consultation paper on the margin framework for non-centrally cleared OTC derivatives in April 2014.<sup>3</sup> To avoid regulatory arbitrage and to ensure a

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<sup>1</sup> The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.7 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> Second Consultation Paper on Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP under Article 11(15) of Regulation (EU) No. 648/2012, June 10, 2015, available at <https://www.esa.europa.eu/documents/10180/1106136/JC-CP-2015-002+JC+CP+on+Risk+Management+Techniques+for+OTC+derivatives+.pdf> (“Consultation Paper”).

<sup>3</sup> Consultation Paper on Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP under Article 11(15) of Regulation (EU) No. 648/2012, April 14, 2014, available at

harmonized implementation of the margin requirements both at the EU level and globally, the ESAs sought in the draft RTS to ensure the international consistency of the margin framework. The ESAs intended to align the draft RTS with the final margin policy framework for non-centrally cleared derivatives developed by the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”).<sup>4</sup>

In response to the Original Consultation Paper, we supported the incorporation into the draft RTS by the ESAs of many key elements of the BCBS/IOSCO Standards.<sup>5</sup> We also noted a number of modifications that we considered necessary to the draft RTS to make them consistent with international standards and more workable for market participants. We generally support the modifications in the Consultation Paper proposed by the ESAs to more closely align the draft RTS with the BCBS/IOSCO Standards. We seek, however, clarification on a number of issues as discussed in more detail below.

### Background

Our members – investment companies that are registered under the Investment Company Act of 1940 and other regulated funds in jurisdictions around the world (collectively, “Regulated Funds”)<sup>6</sup> – use derivatives in a variety of ways. Derivatives are a particularly useful portfolio management tool in that they offer Regulated Funds considerable flexibility in structuring their investment portfolios. Uses of derivatives include, for example, hedging positions, equitizing cash that a Regulated Fund cannot immediately invest in direct equity holdings, managing a Regulated Fund’s cash positions more generally, adjusting the duration of a Regulated Fund’s portfolio, or managing a Regulated Fund’s portfolio in accordance with the investment objectives stated in a Regulated Fund’s prospectus. To employ non-centrally cleared derivatives in the best interests of fund investors, our members have a strong interest in ensuring that the derivatives markets are highly competitive and transparent.

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[https://www.esa.europa.eu/documents/10180/655149/JC+CP+2014+03+\(CP+on+risk+mitigation+for+OTC+derivatives\).pdf](https://www.esa.europa.eu/documents/10180/655149/JC+CP+2014+03+(CP+on+risk+mitigation+for+OTC+derivatives).pdf) (“Original Consultation Paper”)

<sup>4</sup> Margin Requirements for Non-Centrally-Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, September 2013, *available at* <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD423.pdf> (“BCBS/IOSCO Standards”).

<sup>5</sup> ICI Global’s response is available at <https://www.iciglobal.org/pdf/28264.pdf>.

<sup>6</sup> For purposes of this letter, the term “Regulated Fund” refers to any fund that is organized or formed under the laws of a nation, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, such funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or “eligible assets,” concentration limits and/or diversification standards). Examples of such funds include: US investment companies regulated under the Investment Company Act of 1940 (“Investment Company Act”); EU “Undertakings for Collective Investment in Transferable Securities,” or UCITS; Canadian mutual funds; and Japanese investment trusts.

ICI Global members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the derivatives markets. Given that many derivatives transactions are conducted across multiple jurisdictions, we also support efforts for real and meaningful coordination among regulators on how these regulations will be applied to market participants that engage in cross-border transactions. Therefore, we strongly supported the BCBS and IOSCO's efforts to implement consistent global standards for margin requirements for non-centrally cleared derivatives. We believe that, in transposing the BCBS/IOSCO Standards into European law, European regulations must accurately reflect the true intentions of those standards. Faithful transposition of the BCBS/IOSCO Standards into any national law is critical to avoiding duplicative or conflicting margin requirements on cross-border transactions, and we continue to engage with regulators to ensure that the BCBS/IOSCO Standards are adopted consistently around the world.<sup>7</sup>

In that regard, we fully support the efforts made by the ESAs in the Consultation Paper to more fully align the provisions of the draft RTS with the BCBS/IOSCO Standards (including the revised implementation timetable set out in the March 2015 update to the BCBS/IOSCO Standards).<sup>8</sup> Before discussing our responses to the specific questions posed in the Consultation Paper, we make three preliminary comments on the Consultation Paper.

First, we support the approach taken by the ESAs in providing for two-way margining between EU and non-EU entities, rather than requiring only collection of margin by EU entities, thereby conforming the draft RTS with the BCBS/IOSCO Standards. We believe that two-way margin is an essential component of managing counterparty risk for derivatives transactions as well as for reducing systemic risk. The collection of two-way margin helps to protect the individual counterparties to a derivatives transaction and is the most effective risk reduction tool against residual counterparty credit risk. Two-way exchange of initial margin provides each counterparty protection against the future replacement cost in case of a counterparty default.

Second, the introduction of two-way margining highlights the importance to market participants of equivalence determinations and substituted compliance whereby regulators permit market participants to comply with the margin requirements of other regimes. Counterparties established in different jurisdictions engaging in cross-border transactions may be required to comply with a number of different margin regimes and subject to duplicative and conflicting requirements, resulting in unnecessary costs and administrative burden. Accordingly, it is crucial that the European Commission takes action to adopt implementing acts under Article 13 of EMIR declaring the relevant legal, supervisory and enforcement arrangements of other jurisdictions, in particular the United States, as being equivalent to EMIR. Although the responsibility for declaring an implementing act of equivalence resides with the European Commission and not with the ESAs, we wanted to highlight this issue, which will be a critical element in the smooth implementation of

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<sup>7</sup> See Letter from Paul Schott Stevens, President and CEO, ICI, to The Honorable Mary Jo White, Chair, SEC, dated May 11, 2014, *available at* <http://www.ici.org/pdf/28969.pdf>. In the letter, ICI urged the SEC to re-propose its capital, margin, and segregation proposal for security-based swap dealers and major security-based swap participants in a form that is consistent with both international standards and recent proposals of other U.S. regulators.

<sup>8</sup> The revised BCBS/IOSCO Standards were published in March 2015 and are available at <http://www.bis.org/bcbs/publ/d317.pdf>

the draft RTS. Without an equivalence determination by the Commission, Article 13 will have failed its objective of ensuring that counterparties are not subject to duplicative and conflicting regimes.

Third, we strongly support the recognition in the draft RTS that, to properly reflect the potential counterparty risk associated with a particular derivatives transaction, the margin requirements should apply at the individual fund or sub-fund/series level.<sup>9</sup> The EUR 50 million threshold under which counterparties could agree not to exchange initial margin and the EUR 8 billion initial margin threshold under which entities would not be subject to the initial margin requirements would apply for investment funds at the individual fund level.

We, however, seek one change to the drafting of the language in the draft RTS regarding the application at the individual fund level. Since the publication of the Original Consultation Paper, ESMA has published its draft RTS in respect of clearing of certain categories of interest rate derivatives (“Clearing RTS”).<sup>10</sup> The Clearing RTS provide that the EUR 8 billion threshold (used to determine the categories of parties subject to the clearing obligation) be applied at the individual fund level and not at the level of all funds managed by the same investment adviser.<sup>11</sup> Although we believe that the intended effect of Article 2(3) of the Clearing RTS and the provisions in the draft RTS relating to the group definition in respect of investment funds<sup>12</sup> is the same (*i.e.*, to state clearly that investment funds are separate entities for the purpose of the relevant thresholds), the texts in the Clearing RTS and the draft RTS are not consistent and could lead to uncertainty when investment funds seek to apply these provisions. For the sake of consistency and to eliminate uncertainty, the language of the draft RTS should conform to the Clearing RTS.<sup>13</sup>

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<sup>9</sup> Each fund or sub-fund in an umbrella structure (or series) is a separate pool of securities with its own assets, liabilities, and shareholders. In the United States, in creating funds, a sponsor may establish each fund as a new, separately organized entity under state law or as a new “series company,” which has the ability to create multiple sub-portfolios (*i.e.*, individual funds) or series. Series funds are effectively independent for economic, accounting, and tax purposes but share the same governing documents and governing body.

<sup>10</sup> Most recently, Consultation Paper: Clearing Obligation Under EMIR (No.4), 11 May 2015, *available at* [http://www.esma.europa.eu/system/files/esma-2015-807\\_-\\_consultation\\_paper\\_no\\_4\\_on\\_the\\_clearing\\_obligation\\_irs\\_2.pdf](http://www.esma.europa.eu/system/files/esma-2015-807_-_consultation_paper_no_4_on_the_clearing_obligation_irs_2.pdf)

<sup>11</sup> Article 2(3) of the Clearing RTS states: “When counterparties are alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU or UCITS as defined in Article 1(2) of Directive 2009/65/EC, the EUR 8 billion threshold referred to in point (b) of paragraph 1 shall apply individually at fund level.”

<sup>12</sup> Article 6 GEN(3) and Article 7 GEN(3) state: “Investment funds that are managed by a single investment advisor may be considered distinct entities and treated separately in the course of applying the thresholds referred to in paragraph 1, only where the funds are distinct segregated pools of assets for the purposes of fund insolvency or bankruptcy that are not collateralised, guaranteed or supported by other investment funds or the investment advisor itself.” In this regard, we also note the typographical error at Article 1 FP(5), which refers to Article 5 GEN(3) but should presumably refer to Article 7 GEN(3). The reference to “paragraph 1” in this Article is also incorrect and should presumably refer to paragraph 3.

<sup>13</sup> Under the Alternative Investment Fund Managers Directive, any fund that is not a UCITS is by definition an alternative investment fund (“AIF”). Accordingly, a non-EU Regulated Fund would fall within the definition of an AIF for these purposes.

We now turn to the specific questions posed in the Consultation Paper and certain additional modifications to the draft RTS that we consider to be necessary for the RTS to provide clarity to market participants.

Question 1. Respondents are invited to comment on the proposal in the draft RTS concerning the treatment of non-financial counterparties domiciled outside the EU

We strongly support the approach taken in the Consultation Paper with respect to the treatment of non-financial entities below the clearing threshold that are domiciled outside the European Union. In particular, this approach means that EU entities need not exchange collateral with such entities. This approach is consistent with the BCBS/IOSCO Standards, and we agree with the ESAs that non-financial entities below the clearing threshold established outside the European Union share the same risk profile as non-financial counterparties below the clearing threshold within the European Union. Taking the same approach on margin with respect to both sets of entities would prevent regulatory arbitrage.<sup>14</sup>

Question 2. Respondents are invited to comment on the proposal in the draft RTS concerning the timing of calculation, call and delivery of initial and variation margins

*Definition of “Counterparties”*

We recommend that the ESAs clarify the definition “counterparties” throughout the draft RTS. In Article 1 GEN, 1, counterparties are defined as financial counterparties within the meaning of Article 2(8) of EMIR (“FCs”) and non-financial counterparties referred to in Article 10 of EMIR (“NFC+s”). Although this article is consistent with Article 11(3) of EMIR and clearly identifies the entities that are subject to the risk management procedures set out in the draft RTS, the use of this term in the draft RTS creates confusion in a number of areas because the term does not include non-EU entities.

For example, Article 6 GEN, 1, provides that risk management procedures may provide that initial margin is not collected “where the total initial margin required to be collected from a counterparty . . . is equal to or lower than EUR 50 million.” This text suggests that the EUR 50 million threshold is only applicable when FCs and NFC+s are transacting with other FCs and NFC+s and not with non-EU entities. We understand that the ESAs intended for the threshold to apply to all uncleared OTC derivatives contracts between FCs or NFC+s and their counterparties that are classified as FCs, NFC+s, or non-EU entities that would be FCs or NFC+s if they were established in the European Union. Similarly, the text of Article 4 GEN 1, which provides that risk management procedures “may provide that no collateral is collected where the amount due from the last collection of collateral is equal to or lower than a certain amount to be agreed by the counterparties... and which cannot be higher than EUR 500,000,”

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<sup>14</sup> Consultation Paper, *supra* note 2, at 7.

creates confusion regarding the availability of the minimum transfer amount to non-EU entities that would be FCs or NFC+s if they were established in the European Union.<sup>15</sup>

The terms “counterparty” and “counterparties” for purposes of the initial margin threshold, minimum transfer amounts, and the implementation period should not be limited to EU FCs and NFC+s. Accordingly, we urge the ESAs to modify the use of this definition in the above-referenced articles and throughout the draft RTS.

#### *Minimum Transfer Amount*

As in the Original Consultation Paper, the draft RTS propose a minimum transfer threshold whereby an exchange of collateral would be necessary only if the change in the margin requirements exceeds EUR 500,000. As noted in our response to the Original Consultation Paper, for market participants that do not normally deal in Euros (including Regulated Funds that are not denominated in Euros), denominating the threshold level in Euros will cause operational difficulties. We request that entities for which Euros is not the entity’s common or transacting currency be permitted to rely on an average exchange rate between Euros and its common currency calculated on a periodic (*e.g.*, monthly or yearly) basis with the resulting amount rounded to the nearest 100,000.

#### *Mechanics of Transferring Variation Margin*

We strongly support the new provision in the Consultation Paper that requires variation margin to be collected within 3 business days from the calculation date. Article 1 VM, 4 and 5 requires, however, that where collection of variation margin exceeds one business day, the initial margin model must account for the additional period of time when variation margin is not collected and additional initial margin must be collected. We have two concerns with this new proposed requirement. First, it would not be possible to satisfy this requirement in situations in which no initial margin is collected because, for example, the parties are transacting foreign exchange forwards, foreign exchange swaps or currency swaps or one or both of the counterparties are below the relevant initial margin thresholds. Second, we are concerned that this requirement would effectively prevent parties from using the Standardised Method if they post securities as variation margin because many securities cannot be transferred on a T+1 basis. The Consultation Paper does not explain how these requirements operate where counterparties exchange initial margin using the Standardised Method. This requirement therefore would penalize counterparties that may be trading a limited range of products, are below the initial margin thresholds, or are using the Standardised Method by forcing them to post only cash variation margin. We believe that this result would not be in accordance with the intent of the BCBS/IOSCO Standards, which clearly envision a wide range of collateral being used by market participants.

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<sup>15</sup> Article 7 GEN, 1, also provides that risk management procedures “may provide that initial margins are not collected for all new contracts... where one of the two counterparties has or belongs to a group which has an aggregate month-end average notional amount of non-centrally cleared derivatives for the months June, July and August of the preceding year below EUR 8 billion.”

In lieu of Article 1 VM, 4 and 5, we recommend a more workable proposal, whereby variation margin posted with:

- cash would be required to be collected within one business day and
- securities would be required to be collected within three business days.

We believe that these changes will ensure that parties are permitted to post as variation margin the full range of collateral envisaged under the draft RTS.

#### *Mechanics of Transferring Initial Margin*

The draft RTS would require the total amount of initial margin to be recalculated and collected within one business day following one of these events:

- when a new contract is executed;
- when an existing contract expires;
- when an existing contract triggers a payment;
- when an existing contract is reclassified in terms of asset category; or
- when no initial margin recalculation has been performed in the last 10 days.

We request that the ESAs confirm that the recalculations and collections be required no more frequently than once a business day when multiple contracts are executed throughout the day or events occur for multiple contracts throughout the business day. As noted in our response to the Original Consultation Paper, intraday calculations and collections are not necessary, and they can increase operational risk. This frequency also is consistent with the approach that has been taken with respect to the re-evaluation of collateral, which need only occur daily.<sup>16</sup>

#### Question 3. Respondents are invited to provide comments on whether the draft RTS might produce unintended consequence concerning the design or the implementation of initial margin models

The draft RTS require that, upon request by a counterparty, the other counterparty is required to provide all the information necessary to explain the determination of a given value of initial margin in a way that a “knowledgeable third party” would be able to replicate the calculation.<sup>17</sup> In addition, the documentation of the risk management procedures are required to be sufficient to ensure that any “knowledgeable third party” would be able to understand the design and operational detail of the initial margin model.<sup>18</sup>

We strongly support the ESAs’ approach in requiring a party that is using a model to provide full transparency of that model to its counterparty both to ensure that margin is being

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<sup>16</sup> Consultation Paper, *supra* note 2, Article 2 LEC, 1(a).

<sup>17</sup> *Id.* at Article 1 MRM, 4.

<sup>18</sup> *Id.* at Article 6 MRM, 2(a).

calculated appropriately and to permit the counterparty to use the model. Not all counterparties will have the capacity to develop their own model, and some (such as Regulated Funds) may choose to rely on a model that a dealer counterparty has developed. In such a case, the draft RTS recognize that it is critical to ensure the integrity of the model by providing the other party with full transparency of the model, including the assumptions, limitations, and operational details.

We recommend, however, eliminating the “knowledgeable third party” provision. The knowledgeable third party standard would add complexity and confusion without providing substantially additional protection to the counterparty that has not developed the model. We do not see a rationale for requiring that a knowledgeable third party understand the model. The details of the model that one party provides to the other should ensure that the other party is able to understand the design and operation of the model and to replicate the initial margin calculation. Given that the parties are required to agree on the characteristics of the model and on the data used for its calibration,<sup>19</sup> the counterparties would have sufficient knowledge of the operation of the model. The draft RTS should therefore provide that a requesting counterparty be given all the necessary information it requires to enable it to replicate the initial margin calculation without the additional “knowledgeable third party” standard.

Question 4. Respondents are invited to comment on whether the requirements of the draft RTS concerning the concentration limits address the concerns expressed on the previous proposal

The Consultation Paper appears to apply the sovereign debt concentration limits only to systemically important financial institutions and other institutions that engage in significant amount of derivatives transactions. We support this approach to sovereign debt concentration limits. In the Consultation Paper, the ESAs agreed with our concern that diversification requirements may increase, rather than decrease, the risk profile of market participants that may use the sovereign debt of their country of domicile as collateral.<sup>20</sup> Although we agree with the ESAs’ general approach, we urge the ESAs to provide certain clarifications in the draft RTS as set forth below.

First, Recital (27) of the draft RTS states:

Further, concentration limits on collateral might be burdensome for counterparties with small OTC derivative portfolios. Therefore, even though collateral diversification is a valid risk mitigant, non-systemically important counterparties should not be required to diversify collateral.

This paragraph suggests that all concentration limits, rather than just the sovereign debt limits, would not apply to non-systemically important financial institutions.

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<sup>19</sup> *Id.* at Article 1 EIM, 2.

<sup>20</sup> *Id.* at 11.



Second, Article 7 LEC, 2 states that the sovereign debt concentration limits set out in Article 7 LEC, 4 shall apply to the collateral collected “in excess of EUR 1 billion,” whereas Article 7 LEC, 4 would apply the limits to the entire portfolio of collateral and not just the collateral in excess of EUR 1 billion.

We respectfully request that the ESAs clarify the drafting in this section.

Question 5. Respondents are invited to highlight their concerns on the requirements on trading relationship documentation

Article 2 OPD, 2 of the draft RTS states that a counterparty should perform an “independent legal review” at least annually to verify the legal enforceability of its bilateral netting arrangements and should be able to provide documentation supporting the legal basis for compliance of the arrangements in each jurisdiction. We believe that it is appropriate to require counterparties to be satisfied that their netting arrangements are adequate but request clarification of the term “independent legal review.” We seek confirmation that an internal legal review would satisfy this requirement and that parties would not be required to obtain a third-party legal opinion, which would be costly and burdensome.

Question 6. Respondents are invited to comment on the requirements of the draft RTS concerning the legal basis for the compliance (initial margin segregation)

The draft RTS would require segregation arrangements to be in place to ensure that collateral is available if a counterparty defaults.<sup>21</sup> As noted in our response to the Original Consultation Paper, we fully support requirements to segregate a counterparty’s collateral from proprietary assets and the provision to allow the posting counterparty the option of segregating its collateral from the assets of other posting counterparties (*i.e.*, individual segregation).

In addition, the draft RTS would require operational and legal arrangements to be in place to ensure that the collateral is bankruptcy remote. With respect to the legal requirements, the revised draft RTS would require that a counterparty perform an “independent legal review” at least annually to verify that the segregation arrangements meet the requirements set out in Article 1 SEG, 3 and 4 and that the counterparty be able to provide documentation supporting the legal basis for compliance of the arrangements in each jurisdiction. Similar to our response to Question 5 above, we respectfully request the ESAs to confirm that an internal legal review would satisfy this requirement and that parties would not be required to obtain an external legal opinion, which would be difficult and expensive.

Question 7. Does the approach in the draft RTS address the concerns on the use of cash for initial margin

The draft RTS provide that initial margin posted in the form of cash may be reinvested by the collecting party or the custodian for the purpose of protecting the collateral poster and subject to agreement between the parties. We agree but believe the collateral poster should be consulted

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<sup>21</sup> *Id.* at Article 1 SEG, 4.

with respect to the reinvestment of cash collateral and that such reinvestment be only permitted if the parties agree. An agreement between the parties will enable the collateral poster to place limits on the permissible investments of the cash collateral. This additional requirement would be particularly important as certain market participants may be limited or restricted from holding certain investments.

We also seek clarification that the draft RTS would permit counterparties to place cash on deposit with a third party custodian, which is the standard practice for all custody arrangements, both for cash collateral posted and for any cash flows related to the holding of securities under collateral arrangements (such as dividends, distributions, redemption/maturity proceeds, cash generated from reinvestment, etc.). We are concerned that the requirement to segregate cash in the manner proposed by the draft RTS could effectively preclude deposit of cash with a third party custodian. Without the ability to place cash on deposit with a custodian, the use of third-party custody arrangements will not be practicable.<sup>22</sup>

Question 8. Respondents are invited to comment on the requirements of the draft RTS concerning treatment of FX mismatch between collateral and OTC derivatives

The draft RTS would require an 8% haircut to the market value of collateral posted as initial margin where such collateral is denominated in a currency other than the “termination currency” or where the agreement does not identify a “termination currency.”<sup>23</sup> We assume that the reference to a “termination currency” is to the “termination currency” specified in a master agreement, such as the ISDA Master Agreement (*i.e.*, the currency in which termination or close-out amounts are determined). We request that the ESAs clarify the meaning of termination currency.

Moreover, the draft RTS would require an 8% haircut to the market value of collateral posted as variation margin where such collateral is denominated in a currency other than the “transfer currency” and where the agreement does not identify a “transfer currency.”<sup>24</sup> We are not aware of any industry standard document that uses the term “transfer currency.” We therefore recommend that the ESAs clarify the meaning of this term to facilitate the consistent application of this provision and to minimize the likelihood of disputes regarding the intent of this requirement.

Paragraph 5 of Annex II to the draft RTS would not require cash collateral to be subject to a haircut. Paragraphs 6 and 7 of Annex II, which provide for an 8% haircut to assets posted as initial margin and variation margin respectively, refer to “assets” and “assets posted as collateral” and do not clearly identify whether such assets are non-cash assets and/or cash. The explanatory text above Question 8 suggests that cash posted as variation margin should not be subject to a haircut and this approach is consistent with Recital (11) of the draft RTS.<sup>25</sup>

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<sup>22</sup> We recommend that the credit risk to the custodian that might be created by cash on deposit with a custodian be addressed separately and the draft RTS should not prohibit this standard industry practice.

<sup>23</sup> Consultation Paper, *supra* note 2, Annex II, 6.

<sup>24</sup> *Id.* at Annex II, 7.

<sup>25</sup> Recital (11) of the draft RTS states that “[c]ounterparties may choose to cover exposures arising from price variations of their OTC derivative contracts in cash. In this case, the credit arising in connection with such exposures shall be considered to have been settled, considered as a payment and therefore not subject to any haircut.

We request that the ESAs clarify paragraphs 5 to 7 of Annex II as follows:

- paragraph 5 should be amended to provide that cash collateral is subject to a haircut of 0% except as set out in paragraph 6;
- paragraph 6 should be amended to refer to cash and non-cash assets rather than just “assets;” and
- paragraph 7 should be amended to refer to non-cash assets only rather than just “assets.”

#### Additional Comments on Draft RTS

##### *Intragroup Transactions*

The draft RTS provide that certain of the provisions relating to intragroup transactions will apply from entry into force of the RTS.<sup>26</sup> Article 4 IGT is not covered, however, in the implementation provisions, and therefore this article appears to apply from 1 September 2016. We believe the ESAs intended for all intragroup provisions to apply from the entry into force of the RTS and that the counterparties would be able to obtain exemptions for intragroup transactions in advance of the phase-in of the requirements for exchanging initial margin and variation margin. We therefore recommend that the ESAs modify Article 1 FP, 2(a) to include Article 4 IGT.

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We appreciate the opportunity to respond to the Consultation Paper. If you have any questions on our comment letter, please feel free to contact the undersigned, Susan Olson at +1-202-326-5813, or Jennifer Choi at +1-202-326-5876.

Sincerely,

/s/

Dan Waters  
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cc: The Honorable Timothy G. Massad  
The Honorable Mark P. Wetjen  
The Honorable Sharon Bowen  
The Honorable J. Christopher Giancarlo

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<sup>26</sup> Consultation Paper, *supra* note 2, Article 1 IGT, Article 2 IGT, and Article 3 IGT.

The Honorable Mary Jo White

The Honorable Luis A. Aguilar

The Honorable Daniel M. Gallagher

The Honorable Kara M. Stein

The Honorable Michael S. Piwowar