

**Meeting Between Staff from the Federal Reserve and
Representatives of International Swaps and Derivatives Association
February 25, 2013**

Participants: Sean Campbell, Anna Harrington, and Chris Paridon (Federal Reserve).

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Stephen O'Connor (Morgan Stanley); and Oliver Frankel (Goldman Sachs)

Summary: Representatives from the International Swaps and Derivatives Association (the “Representatives”) met with staff from the Federal Reserve to discuss issues related to the proposed rule issued by the Federal Reserve and other prudential regulators on margin and capital requirements for covered swap entities under Title VII of the Dodd-Frank Act.

Among matters discussed in the meeting were certain areas of clarification regarding the Consultative document of the Working Group on Margining Requirements, including: diversification benefits, haircuts on collateral on currency, results of the quantitative impact study, and certain calculation issues. The areas discussed are described more fully in the attachment.

Attachment

BCBS 242 Areas for Clarification:

1. Key Principle 8:

Paragraphs 8.1 to 8.8. Is it the case that both during and after the phase in period a firm whose aggregate month end notional amount of non-centrally-cleared-derivatives as defined in paragraph 8.3 is less than the limits set out in paragraphs 8.4 to 8.8 is **not** a covered entity and therefore neither the firm, nor any dealer with whom it trades (which may be above the relevant threshold) are required to post margin in respect of these trades?

We note that paragraph 2.6 states “Only non-centrally cleared derivative transactions between two covered entities are governed by the requirements in this paper.” Does this apply during the transition period?

2. Estimates of the Size of the Market

In order to better understand the methodology used in the QIS, we believe that full details of the calculations made and assumptions used should be published. In particular we would like to see the methodology used to calculate IM requirements from the QIS sample, as well as additional results for the current non-centrally-cleared market in addition to the results provided for the non-centrally-clearable market.

3. Collateral

We note that the QIS results show that model-based margin requirements comprise 8% of available margin eligible assets under the near-final proposal. It implies that the assumed available margin eligible assets is approximately \$11tr (being equal to \$0.9tr divided by 8%). As noted above, given the importance of estimating the total available margin eligible assets in the financial system and in order to ensure a meaningful comparison with the First Consultative Paper’s proposals’ impact, ISDA would welcome further details on the methodology used to arrive at this \$11tr figure.

4. Haircut on Collateral in Currency different from Derivatives

Appendix B requires an 8% additional haircut for collateral denominated in a currency other than that of the denomination of the derivatives portfolio. What if the portfolio contains derivatives with denominations in several currencies?

How is the rule intended to work with the industry proposal for a standard CSA for uncleared trades, wherein a single currency is chosen so as to minimize Herstatt risk across the industry?

5. Calculation of Limits

Will exempt physically settled FX forwards and swaps count towards the "*aggregate month-end average notional amount of non-centrally-cleared-derivatives*" used to calculate the phase-in thresholds?

6. Diversification Benefits

Requirement 3 lists "*currency/rates*" as one asset class. Do we understand correctly that netting between currency products and rates products would be allowed?

7. Paragraph 3.1 of BCBS 242 states:

For purposes of informing the initial margin baseline, the potential future exposure of a non-centrally cleared derivative should reflect an extreme but plausible estimate of an increase in the value of the instrument that is consistent with a one-tailed 99 percent confidence interval over a 10-day horizon,(footnote12) based on historical data that incorporates a period of significant financial stress (footnote13).The initial margin amount must be calibrated to a period of financial stress to ensure that sufficient margin will be available when it is most needed and to limit the extent to which margin can be procyclical. The required amount of initial margin may be calculated by reference

Footnote 13, states:

Because of the discrete subset of transactions covered by the margin requirements, these assumptions differ somewhat from the assumptions used to calculate potential future exposure under the Basel regulatory capital framework for OTC derivatives.

What does this mean and why the differences?