INSTITUTE OF INTERNATIONAL BANKERS

Richard Coffman
General Counsel
E-mail: rcoffman@iib.org

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1149
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Robert E. Feldman, Executive Secretary
Attention: Comments/RIN 3064-AE70
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Eighth Floor
400 7th Street SW
Washington, DC 20219

Barry F. Mardock, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Margin and Capital Requirements for Covered Swap Entities (OCC Docket ID OCC-2018-0003); (FRB Docket No. R–1596; RIN 7100 AE-96); (FDIC RIN 3064-AE70); (FHFA RIN 2590–AA92)

Ladies and Gentlemen:

The Institute of International Bankers ("**IIB**") appreciates the opportunity to provide comments to the Prudential Regulators[1] in response to the above-captioned proposal (the "**Proposed Rule**")[2] to amend the final rules regarding margin requirements for uncleared swaps entered into by swap dealers and major swap participants (the "**Swap Margin Rules**")[3] by

[1] In this letter, "**Prudential Regulators**" refers to the Board of Governors of the Federal Reserve System (the "**Board**"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration.

[2] 83 Fed. Reg. 7413 (Feb. 21, 2018).

[3] 80 Fed. Reg. 74840 (Nov. 30, 2015).

(i) amending the definition of eligible master netting agreement to align with the definition of qualifying master netting agreement in the federal banking agencies' regulatory capital and liquidity rules and (ii) clarifying that a legacy swap that is not currently subject to the requirements of the Swap Margin Rules would not become subject to the requirements of the Swap Margin Rules if the swap was amended solely to comply with the requirements of the final rules imposing restrictions on the termination rights in certain qualified financial contracts (the "**QFC Stay Rules**").[4]

We appreciate the Prudential Regulators' efforts to clarify the treatment of amendments made to comply with the QFC Stay Rules under the Swap Margin Rules. However, amendments made to comply with the QFC Stay Rules are only one example of amendments that should not trigger the application of the Swap Margin Rules. We are also concerned about the treatment of amendments driven by regulations or legislation similar to the QFC Stay Rules that have been promulgated in other jurisdictions.[5] In our comments below, we recommend that, instead of a rule amendment, the Prudential Regulators adopt guidance setting out a principles-based approach to clarify the treatment of amendments under the Swap Margin Rules generally, including risk-reducing amendments and amendments made to satisfy other regulatory requirements.

In the preamble to the Swap Margin Rules, the Prudential Regulators rejected requests to classify "new swap transactions as 'swaps entered into prior to the compliance date' [of the Swap Margin Rules]" out of a concern that doing so could "create significant incentives to engage in amendments and novations for the purpose of evading the margin requirements."[6] In the Proposed Rules, the Prudential Regulators reiterated concerns about the potential evasion of the Swap Margin Rules "if legacy swaps could be materially amended and remain not subject to the requirements of the [Swap Margin Rules]" as well as the potential difficulty of administering an approach that was based on the materiality or purpose of amendments or novations.[7]

The Prudential Regulators could still address these concerns if they utilized previously issued guidance around when an amendment to an existing swap constitutes a "new" swap when determining whether an amendment to an existing swap brings such swap into scope of the Swap Margin Rules. Under Title VII of the Dodd-Frank Act, the generally applicable test for whether

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[4] 82 Fed. Reg. 56630 (Nov. 29, 2017); 82 Fed. Reg. 50228 (Oct. 30, 2017); 82 Fed. Reg. 42882 (Sept. 12, 2017).

[5] For example, other jurisdictions, such as the France, Germany, Italy, Japan, Switzerland and the United Kingdom, have introduced legislation or regulations similar to the QFC Stay Rules. As with the ISDA 2015 Universal Resolution Stay Protocol and the ISDA 2018 U.S. Resolution Stay Protocol, the ISDA industry-standard compliance mechanisms for these stay regulations amend existing financial contracts.

[6] 80 Fed. Reg. 74840, 74851.

[7] 83 Fed. Reg. 7413, 7418 note 37.

an amendment or modification to an existing swap would create a "new" swap and, therefore, trigger subsequently implemented requirements, is whether the amendment relates to a "material" term of the swap.[8] For example, the CFTC and SEC have identified an amendment of a swap to reflect the replacement of a "key person" of a hedge fund with a new "key person" as an amendment "not to a material term" of the swap, and they contrasted such an amendment with one that would change the reference securities underlying the swap, which they would view as material.[9] In most instances, an amendment to a material term is distinguished by the fact that it is accompanied by a change to the swap's pricing.

In addition, in the context of Title VII's clearing requirement, the CFTC has clarified the treatment of early terminations, novations, portfolio compression exercises and swaps resulting from the exercise of a legacy swaption.[10] These clarifications regarding early terminations, novations and portfolio compression exercises promote *bona fide* risk-reducing activity. In the case of legacy swaptions, they prevent counterparties from facing unforeseen liquidity demands due to events outside their control.

We believe that the foregoing analysis should also be relevant for the purposes of the Swap Margin Rules. The approach taken under Title VII is familiar to industry participants and more consistent with the views in other jurisdictions. Over the years in which it has been used in connection with CFTC rules, this approach has not proven to give rise to evasion risk—as immaterial amendments are not substitutes for new swaps—or difficulty of administration. Thus, we do not think it raises the concerns cited by the Prudential Regulators.

In addition, we are concerned that taking a different approach, which treats all amendments other than those related to the QFC Stay Rules as triggering the Swap Margin Rules, would actually be more difficult for the Prudential Regulators to administer in practice. This broader approach would require further amendments to the Swap Margin Rules each time legacy swaps are required to be amended to satisfy new regulations or legislation in one or more jurisdictions. For example, it is possible that legacy swaps will be required to address other regulations relating to resolution regimes. Our proposed approach provides more flexibility for the Prudential Regulators to address regulatory amendments through guidance rather than requiring additional formal rulemaking processes for each regulatory change. It also presents

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8 Commodity Futures Trading Commission ("**CFTC**") and Securities and Exchange Commission ("**SEC**"), Joint Final Rule, "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement;' Mixed Swaps; Security-Based Swap Agreement Recordkeeping." 77 Fed. Reg. 48208, 48286 (Aug. 13, 2012) (the "**Product Definitions**"). The Product Definitions were adopted as a joint rule by the CFTC and the SEC, in consultation with the Board.

9 *Id.*, note 894.

10 77 Fed. Reg. 4441, 44445 (Jul. 30, 2012); CFTC Letter No. 13-01 (Mar. 18, 2013); CFTC Letter No. 13-02 (Mar. 20, 2013).

certainty to market participants that ministerial, non-economic updates or clarifications would not bring a legacy swap into scope of the Swap Margin Rules.

Applying our proposed approach to amendments made under the QFC Stay Rules would result in such amendments not bringing a legacy swap into scope under the Swap Margin Rules. Under the QFC Stay Rules, regulated entities must conform their existing in-scope qualified financial contracts with counterparties in order to continue entering into new QFCs with such counterparties. Because amendments made to legacy swaps to comply with the QFC Stay Rules would not affect the material economic terms of the swaps, such amendments should not result in new swap transactions that would be subject to the Swap Margin Rules. Amendments made to comply with the QFC Stay Rules only affect the ability of a counterparty to exercise certain termination rights; accordingly, such amendments are more akin to changes to a "key person" provision, which also creates termination rights for counterparties, than amendments that affect the economic profile of the swap for the purposes of the Product Definitions. In addition, since such amendments would be made for the purpose of complying with certain of the Prudential Regulators' own regulatory requirements, such amendments do not raise the risk of evasion identified by the Prudential Regulators.

In addition, certain risk-reducing amendments, while impacting a material economic term of a swap, also should not qualify as a "new" swap under the existing Product Definition analysis of amendments or our proposed Swap Margin Rules analysis. Risk-reducing amendments, such as partial terminations or partial novations, decrease exposure to uncleared derivatives. Subjecting such risk-reducing amendments to the Swap Margin Rules would discourage effective risk management practices. This outcome would be contrary to the policy goals of the Swap Margin Rules, which are intended to mitigate counterparty credit risks.[11]

Another type of amendment that the Prudential Regulators should not treat as triggering the Swap Margin Rules are changes to elect a replacement rate for LIBOR and other reference rates subject to discontinuation as part of a transition process managed by regulatory authorities. Although a change to the underlier for a swap would generally constitute a material amendment, and thus trigger the Swap Margin Rules under the general approach described above, in instances where regulators are managing the discontinuation of a reference rate such a change is necessary to mitigate basis risk and exposure to fallback rates not intended to operate for the duration of a contract. In this context, changing the underlier is not a substitute for entering into a new swap so much as it is an effort to retain the economics of the existing swap following a reference rate discontinuation.

If the Prudential Regulators decide to move forward with the rule amendment as proposed, then, in order avoid providing a negative implication for the treatment of these categories of amendments under the Swap Margin Rules, we suggest that the Prudential

[11] The stated purpose of the margin requirements is to "offset the greater risk to such entities and the financial system arising from the use of swaps that are not cleared." 79 Fed. Reg. 57347, 57386.

Regulators also (i) adopt this principles-based approach as guidance in the rule's preamble and (ii) frame the proposed exception for amendments made to comply with the QFC Stay Rules as a "safe harbor" intended solely to provide clarity and certainty around the application of the analysis described above to such amendments. This approach is consistent with the preamble to the Proposed Rules, which includes statements that the Proposed Rules are intended "to provide clarity to market participants" and "provide certainty to a covered swap entity and its counterparties" in light of the QFC Stay Rules. It would also allow the Prudential Regulators and the industry to adopt the more flexible, principles-based approach described above for determining when an amendment to a legacy swap brings such swap into the scope of the Swap Margin Rules.

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The Institute appreciates the consideration of these matters by the Commission. Please do not hesitate to contact the undersigned with any questions regarding this letter.

Respectfully submitted,

Richard Coffman
General Counsel
Institute of International Bankers