June 24, 2011

VIA ONLINE SUBMISSION: http://www.regulations.gov; http://www.fdic.gov/regulations/laws/federal/propose.html; http://www.fca.gov; http://comments.cftc.gov

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Federal Deposit Insurance Corporation
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Attention: Comments, Federal Deposit Insurance Corporation

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Board of Governors of the Federal Reserve System
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Alfred M. Pollard
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
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Washington, D.C. 20552

Subject:

1. **OCC – Docket ID OCC-2011-0008 – Capital and Margin Requirements**

2. **Board of Governors of the Federal Reserve System – Docket No. R-14XX and RIN 7100 ADXX - Capital and Margin Requirements**

3. **FDIC – RIN: 3064 - AD - Capital and Margin Requirements**

4. **Federal Housing Finance Agency – Comments/RIN 2590 - AA45 - Capital and Margin Requirements**

5. **Farm Credit Administration – RIN 3052 - AC69 – Capital and Margin Requirements**

JPMorgan Chase & Co. ("JPMorgan" or "JPM") welcomes the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation (the "FDIC"), the Farm Credit Administration (the "FCA"), the Federal Housing Finance Agency (the "FHFA") and the Office of the Comptroller of the Currency (the "OCC") (collectively the "Prudential Regulators") relating to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (the "Margin Rulemaking"). The Margin Rulemaking relates to proposed rules under Section 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act"). Any capitalized terms not otherwise defined herein shall have the meaning assigned to such term in Dodd-Frank or the Margin Rulemaking, as applicable.

The Margin Rulemaking

There are a number of requirements of the Margin Rulemaking that are significant, represent a change from current market practices and have the potential to have a significant adverse effect on the market for uncleared swaps and on the competitiveness of Swap Dealers that are organized under the laws of the United States and certain of their international affiliates.

All agreements between Swap Dealers will require each Swap Dealer to post Initial Margin to the other, and all such Initial Margin must be held in a segregated account with an independent third party custodian that is subject to the same insolvency regime as the Swap Dealer that receives the Initial Margin. [Margin Rulemaking Proposed Common Rule Sections 3 and 7].

1. All agreements between Swap Dealers and Financial End Users ("FEs") will require FEs to post Initial Margin to the Swap Dealer. [Margin Rulemaking Proposed Common Rule Section 3].

2. All agreements between Swap Dealers and Nonfinancial End Users will be required to have "Credit Support Arrangements" in place and will require a Nonfinancial End User to pledge Eligible Collateral as Initial Margin and Variation Margin to a Swap Dealer if the relevant thresholds are exceeded. [Margin Rulemaking Proposed Common Rule Section 5].

3. The only Eligible Collateral recognised by the Prudential Regulators for trades between Swap Dealers, Major Swap Participants and FEs will be U.S. Treasury Securities, U.S. Agency Securities, U.S. Dollar Cash and "cash in the currency in which the swap is settled." [Margin Rulemaking Proposed Common Rule Section 6].

4. All requirements of the Margin Rulemaking apply outside of the United States except for swaps where (i) the Swap Dealer is a Covered Swap Entity that is not a U.S. incorporated entity or is an entity that is not controlled by a U.S. incorporated entity and (ii) the counterparty is an entity that is not a U.S. incorporated entity or whose obligations are not guaranteed by a U.S. incorporated entity. [Margin Rulemaking Proposed Common Rule Section 9]. The effect of this is that U.S. Banks and their non-U.S. branches, as well as certain non-U.S. subsidiaries and affiliates, will always be subject to these requirements, even when transacting with counterparties that have no nexus with the U.S.

General

Section 731 of Dodd-Frank sets out the standards that the Prudential Regulators must follow in determining margin requirements for uncleared swaps:

"(3) STANDARDS FOR CAPITAL AND MARGIN.—
(A) IN GENERAL.—To offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared, the requirements imposed under paragraph (2) [the Margin Requirements] shall—
(i) help ensure the safety and soundness of the swap dealer or major swap participant; **and**
(ii) **be appropriate** for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant. "
(emphasis added)

JPMorgan fully supports the Prudential Regulators' efforts to increase transparency in the swap markets, reduce systemic risk in the financial markets, and promote market integrity. Many aspects of the Margin Rulemaking would further those goals. In several areas, however, the Margin Rulemaking would severely reduce liquidity in swap markets and reduce the competitiveness of U.S. swap entities, without any reduction in systemic risk or increase in market integrity. The Margin Rulemaking in several instances imposes requirements that are not risk based and that would seriously diminish market liquidity. Congress did not intend that the Prudential Regulators adopt a one-size-fits-all approach to setting margin requirements for uncleared swaps; if that were the case, then (ii) above would not have been necessary. Indeed, Congress intended margin requirements under Section 731 to be risk-based and required that those requirements be appropriate to address the associated risks. In the case of Nonfinancial End Users, those associated risks are low, and Congressional intent manifestly was to exclude non-cleared swaps entered into with Nonfinancial End Users from the margin requirements. In the case of Financial End Users and other Swap Dealers and Major Swap Participants, the determination of appropriateness must take into account differences between these entities. In all cases, the Prudential Regulators must recognize that there is a cost to collateralization as well as a benefit, which cost can extend to the competitiveness of the US financial system. The margin requirements must be made on the basis of that cost-benefit analysis, the calibration between ensuring safety and soundness and setting requirements that are appropriate for the relevant risk. Our detailed comments are as follows.

Initial Margin Requirements

The Margin Rulemaking mandates that (i) all agreements relating to uncleared swaps between Swap Dealers must require each Swap Dealer to post Initial Margin to the other and (ii) all agreements relating to uncleared swaps between Swap Dealers and FEs must require the FEs to post Initial Margin to the Swap Dealer (the amount of such margin depends on whether the FE meets certain criteria set forth by the Prudential Regulators). These requirements are inconsistent with proven market practice, ignore significant differences in credit quality among Swap Dealers and FEs which justify differential margining treatment and will lead to excessive amounts of collateral being required in comparison to the actual risks of the underlying swap transactions and portfolios.

1. **The Initial Margin Requirements Should Differentiate Based on Credit Quality**. Section 731 explicity requires margin requirements to reflect risk, yet the Margin Rulemakings ignore the credit quality of Swap Dealers and instead impose a zero threshold on all. Swap Dealers generally are of high credit quality; for example, at JPMorgan the 34 entities that we treat as Swap Dealer counterparties have an average long term debt rating of A+/A1. Swap Dealers already have two way variation margining arrangements in place with zero thresholds with other Swap Dealers, and these arrangements performed quite well during the financial crisis of 2008. The Margin Rulemaking identifies no risk-based justification for layering zero threshold, bilateral Initial Margin requirements for all Swap Dealers above and beyond their existing variation margin arrangements. Initial Margin is appropriate in some circumstances, but it must to take into account the credit quality of counterparties.

    Unlike Swap Dealers, which are generally of high credit quality, there is a wide spectrum of credit quality in the broad category of Financial End Users. Many pension plans, sovereigns and supranationals, for example, are of extremely high credit quality, as reflected in their credit ratings and/or their ability to borrow on an unsecured basis. At the other end of the credit spectrum, many hedge funds, for example, are highly leveraged and are of lower credit quality. Many of these types of entities already are required to post Initial Margin to their dealer counterparties. To fulfill the Congressional mandate to set appropriate margin requirements, we believe that there should be a risk based approach to requiring Initial Margin to be posted by FEs, which approach would take into account the credit quality of such entities based upon a Swap Dealer's internal credit analysis of its counterparty, instead of requiring all such entities to post Initial Margin regardless of credit quality.

    There are, of course, difficult issues involved in measuring the credit quality of individual entities, and overreliance on rating agency credit ratings should be avoided. This is an issue that banks face in many of their existing businesses, and cannot justify requiring swap dealers to ignore risk in setting Initial Margin requirements.

2. **The Time Horizon required to be used by the Internal Initial Margin Model is unjustifiably long**. The Margin Rulemaking specifies a time horizon for the Initial Margin model of 10 business days, compared with a typical 3-5 business day time horizon used by derivatives clearinghouses. The reason cited for the longer time horizon is the lesser liquidity of uncleared swaps. It is important to remember, however, that one of the main purposes, if not the sole purpose, of Initial Margin is to serve as a buffer against market movements during the time between variation margin calls. All Swap Dealers have margin agreements allowing for daily variation margin calls on swap portfolios, and many Financial Entities, particularly hedge funds, have similar arrangements. Under the documentation governing the swap portfolios and margining, failure to meet a variation margin call results in an event of default after 1 business day, and the nondefaulting party then has to wait another business day before it can terminate the swap portfolio. Even taking into account delays and time slippage, the termination

should take place within 5 business days of the failure to meet the variation margin call. Termination of the swap portfolio entails liquidation of all open positions, and once that liquidation has occurred, there is no need for, and in fact no legal basis to require, Initial Margin. Consequently, the time horizon for Initial Margin should reflect the expected time period to terminate a swap portfolio after a failed margin call, and we believe a conservative approach to that time period would be result in a 5 business day time horizon.

3. **The Initial Margin Model Should Recognize Offsetting Exposures under a Qualifying Master Agreement across Broad Risk Categories.** The legal risk of transactions executed under a qualifying master agreement is the net exposure across the whole portfolio covered by the Agreement. The Margin Rulemaking allows only for offsetting of exposures within broad risk categories. It is important here again to emphasize that the purpose of Initial Margin is to protect against market moves between variation margin calls, and variation margin calls always are made across broad risk categories, i.e. across the entire portfolio of swaps governed by the qualifying master agreement. Not allowing for Initial Margin to be called on that basis results in a far greater margin posting requirement than the actual potential exposure.

4. **The Initial Margin Requirements will Result in a Huge Drain of Liquid Assets from the U.S. Economy.** The Initial Margin requirements of the Margin Rulemaking will require very large amounts of collateral to be posted as Initial Margin and placed in segregated custodial accounts. JPMorgan has attempted to size this by calculating the amounts of Initial Margin that we would have to collect from 34 of our largest professional dealer counterparties by reference to the "Lookup Table" percentages of notional approach set forth in Appendix A to the Margin Rulemaking. Application of that approach to our existing portfolio of transactions with those 34 counterparties yielded a total amount of Initial Margin that JPMorgan would have to collect equal to \$1.4 trillion. Since the inter dealer Initial Margin requirements are reciprocal, JPM would also be obligated to post \$1.4 trillion.

   It is likely that most swap dealers will use the model based approach, and not the "Lookup Table", to calculate required Intitial Margin. Since the model based approach premits netting of long and short positions, it is likely that it will produce smaller Initial Margin amounts. There is substantial uncertainty, however, about the model approval process and timing and accordingly the large amounts resulting from application of the Lookup Table are quite relevant. There is no indication in the Margin Rulemaking that there has been a thorough analysis of either the costs to market participants or to the economy as a whole of funding these very substantial amounts of collateral.

   We also note that there is potential for an impact to the system, and particularly to the impact on liquidity in the U.S. Treasury securities market, of requiring potentially trillions of dollars of cash, U.S. Treasury and Agency securities to sit idle in third party custodial arrangements.

5. **The Definition of Eligible Collateral Is Too Restrictive.** By permitting only the posting of U.S. Dollar cash or U.S. Treasury or Agency Securities, the Margin

Rulemaking unnecessarily restricts the types of collateral that can be posted as margin. Current market practice, as well as sound risk management practices, permits the posting of a much wider variety of securities collateral including additional types of U.S. Dollar denominated collateral and securities collateral denominated in a number of foreign currencies, particularly OECD government securities. Variations in credit quality are taken into account by haircuts, an approach which the Prudential Regulators already take with respect to Treasuries and Agencies. The Prudential Regulators cite no legitimate systemic risk reduction objective for making the definition of Eligible Collateral so restrictive. In fact, the restriction to Treasuries and Agencies is not supported by the relevant statutory provision in Dodd-Frank. Section 731 specifically allows the use of non-cash collateral if the Prudential Regulators determines such use to be consistent with "(i) preserving the financial integrity of markets trading swaps; and (ii) preserving the stability of the United States financial system." The pervasive current use of other types of securities as collateral, with no evidence of credit concerns resulting therefrom, evidences that the financial integrity of the markets would be best preserved through an expanded definition of Eligible Collateral, and appropriate haircuts would preserve the stability of the U.S. financial system. In this regard, we note that the Commodity Futures Trading Commission (the "CFTC"), in its Notice of Proposed Rulemaking relating to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (the "CFTC Rulemaking"), allows "assets for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the credit support arrangements" as collateral that Nonfinancial End Users can post. We believe this formulation of acceptable collateral should form the basis for an expansion of the categories of Eligible Collateral in the Margin Rulemaking. We also note that the Basel capital rules envision a wider range of acceptable collateral.

6. **Transactions between U.S. Banks and Their Subsidiaries and Affiliates Should Be Excluded From The Margin and Segregation Requirement.** U.S. banks often engage in derivatives transactions with their subsidiaries and affiliates in order to manage risk effectively among their legal entities. These transactions do not increase risk; instead they transfer risk within the corporate group to an entity that is better positioned to manage that risk. The initial transaction still would be subject to the full range of provisions in the Margin Requirements and Dodd-Frank, and thus the further risk management transactions that transfer risk internally pose no incremental systemic risk issues. We believe transactions between a U.S. bank and its subsidiaries should be exempt from the Initial Margin and Variation Margin requirements. Consequently, we believe there is no safety and soundness benefit from having a U.S. bank that is a swap dealer exchange Initial and Variation Margin with its subsidiaries, and there could be a significant cost and competitive disadvantage, for the reasons discussed above. Transactions between a U.S. bank and its affiliates are already covered by Sections 23A and 23B of the Federal Reserve Act and Board Regulation W, as augmented by Section 608 of the Act, and we believe that statute and regulation, with their long history of use in the market, provide the appropriate regulatory oversight of these transactions. Lastly, we note that in the latest version of the draft European Market Infrastructure Regulation, it is proposed that there be a broad intra-group exemption from clearing and margining for non-cleared trades that would apply to financial institutions.

7. **Requiring the Independent Custodian be Located in the Same Jurisdiction as the Pledgor is Unclear, Unsupported by Law or Policy and Impractical.** The Margin Rulemaking requires that the "independent custodian shall be located in a jurisdiction that applies the same insolvency regime to the custodian as would apply to the covered swap entity". This requirement is unclear and, if taken literally, will make compliance impossible; moreover, no justification is given for it. This requirement is unclear because there is no definition of what "same insolvency regime" means. For example, it is unclear whether the FDIC insolvency regime applicable to U.S. banks and the U.S. Bankruptcy Code applicable to non-bank debtors are the same or different insolvency regimes. They are both creatures of U.S. law and both deal with insolvency, but they have important substantive differences. As another example, are the different sets of provisions in the FDIC Insolvency statute applicable to (i) Qualified Financial Contracts and (ii) funds held by a bank as custodian the same or different insolvency regimes? If taken literally, this requirement will be impossible to comply with and is impractical. In the United States, all independent custodians currently operate as banks, which as noted above are subject to an FDIC insolvency regime. Under Section 716 of Dodd-Frank, certain enumerated swap activities will have to be "pushed out" to non-bank holding company affiliates. These non-bank affiliates will be subject to the insolvency regime established by the U.S. Bankruptcy Code. These entities could never comply with the segregation requirement because no independent custodian operating in the U.S. is subject to the Bankruptcy Code.

8. **The Definition of Independent Custodian Should be Clarified to Include Affiliates.** A definition of "independent" which does not include affiliates creates several results which are inconsistent with the intent of the margin requirements. As noted in the previous paragraph, such a limited definition would require U.S. banks and their subsidiaries to deliver Initial Margin to an unaffiliated custodian in connection with their swap transactions. That definition would very likely also create the unintended consequence of directing a substantial amount of the Initial Margin for swap transactions involving entities with an affiliated custodian to a very limited number of other custodians. Entities selecting such other custodians once may be compelled to do so on many (if not all) of their swap transactions in order to create operational efficiencies. As a result, the negative impact on the system could be great, with hundreds of billions, if not trillions, of dollars in Initial Margin being held by a limited number of custodians.

9. **The Timing of the Initial Margin Requirement is Too Restrictive.** The Margin Rulemaking sets forth a requirement for parties to "comply with the initial requirements…on or before the date it enters into such swap or security-based swap…" This is inconsistent with current market practice, will require significant and burdensome changes in operational processes and be of little benefit in reducing systemic risk.

   Margin calculations are done, by necessity, on a backward looking basis. Participants in the swap market calculate an overall margin requirement, consisting of an aggregate amount of initial margin, if required, and variation margin, across the entire portfolio of transactions between the parties based upon values of the close of business of the immediately preceding business day. The party obligated to deliver an overall margin amount, which may be a mix of initial margin and variation margin, generally has until the close of business on the next business day to deliver the required margin. This timing is dictated by operational realities-it takes time to calculate the required margin amount, and it also takes time for the party receiving the margin demand to double check the calculations before sending the required margin. It is simply not possible to send initial margin on the trade date of a transaction, and requiring this could in fact be risk increasing. For example, it is possible that a party that is required to pay initial margin in respect of a transaction done today could, on an overall basis, be entitled to a return of margin, calculated with respect to the entire portfolio, tomorrow. Requiring that party to deliver initial margin in respect of the transaction done today when he is entitled to an overall return of margin tomorrow is, for that party, risk increasing, not risk reducing. The Margin Regulations should recognize operational realities and mandate timing requirements for delivery of initial margin that accord with current market practice.

Extraterritorial Application

The Margin Rulemaking contains provisions concerning its application outside of the United States that go far beyond what has been proposed in any Dodd-Frank Title VII rulemaking to date, are contrary to longstanding principles of bank regulation of overseas banking activity and will create a severe competitive disadvantage for U.S. banks. The Margin Rulemaking Common Rule Section 9 provides a limited exception to the application of the other parts of the Margin Rulemaking. This exception requires two tests to be met. First, a transaction must be a "foreign non cleared swap", which is met only by entities that are not organized under the laws of the United States or entities whose performance is not guaranteed by an entity organized under the laws of the United States. Second, the transaction must be entered into with a "foreign covered swap entity". To qualify as a foreign covered swap entity, the covered swap entity cannot be organized under the laws of the United States and cannot be a branch or subsidiary of an entity organized under the laws of the United States.[1] In other words, U.S. banks and certain of their subsidiaries and affiliates, wherever located and however regulated, are subject to the Margin Rulemaking with respect to all of their swap activities globally. This is an unprecedented expansion of U.S. bank regulatory authority over the overseas activities of U.S. bank branches and certain subsidiaries and affiliates. The proposed rule extends margin requirements to the overseas operations of U.S. swap dealers, placing them at a severe and untenable competitive disadvantage to their foreign bank competitors. This outcome is contrary to the letter and spirit of Dodd-Frank, as well as long standing principles of bank regulation.

1. **Extraterritorial Application is Contrary to Longstanding Statutes and Regulations Governing U.S. Banks' non-U.S. Swap Activity.** Many U.S. banks, including JPMorgan, conduct their swaps activities overseas through non U.S. branches, bank

[1] The definition of "covered swap entity" requires that the relevant entity be a "swap entity", which itself requires that the relevant entity be registered as a swap dealer. We believe that an Edge Act subsidiary that enters into swaps only outside the United States and only with non-US counterparties does not have to register as a swap dealer as long as the transactions are not intended to evade the requirements of Title VII of Dodd-Frank. See http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27927&SearchText=Sullivan.
An Edge Act subsidiary that is not registered as a swap dealer is not a covered swap entity for purposes of the Margin Rulemaking.

holding company subsidiaries and Edge Act subsidiaries of their U.S. banks. This is a longstanding practice of U.S. banks' operations overseas and long pre-dates the enactment of Dodd-Frank. Under Board Regulation K, U.S. banks are permitted to establish branches in foreign jurisdictions with the approval of or with prior notice to the Board. Non U.S. subsidiaries of bank holding companies are subject to applicable law and regulation in the countries in which they are organized and are subject to supervision by the Board. Edge Act subsidiaries are corporations established under Section 25A of the Federal Reserve Act and are subject to supervision and regulation by the Board.

Non U.S. branches generally have the same powers as are exercisable by foreign entities operating in the place where the non-U.S. branch is operating, and Edge Act subsidiaries are authorized to exercise such powers as are necessary to enable them to compete effectively with entities operating in the jurisdictions in which they do business. In sum, branches and subsidiaries of U.S. banks operating overseas have traditionally been authorized to engage in a wider range of activities than their U.S. parent bank to enable them to compete in international markets, and regulation of these branches and subsidiaries has been accomplished through supervision by the Board and by local regulators. The Margin Rulemaking abrogates this longstanding tradition by imposing its margin rules on branches, Edge Act subsidiaries and subsidiaries of U.S. bank holding companies operating overseas.

2. **Extraterritorial Application puts U.S. Banks at a Competitive Disadvantage.** Application of the Margin Rulemaking to JPMorgan's non-U.S. activities would put it at a severe competitive disadvantage. Applying the Margin Rulemaking to our non-U.S. activities would subject those activities to an additional regulatory regime that our foreign competitors are not subject to. This competitive disadvantage would be particularly severe given some of the very restrictive provisions in the Margin Rulemaking. The restrictive definition of Eligible Collateral is a good example of this. As discussed above, the Margin Rulemaking only permits U.S. Treasuries and Agency Securities as non-cash collateral; sovereign debt of European countries is not permitted. Applying this rule to JPMorgan's overseas business would put JPMorgan in the position of requiring European counterparties to post margin to JPMorgan when they would not be required to do so when dealing with French, German or British banks and would not even permit them to satisfy this requirement by posting European sovereign debt securities as collateral! This would be a disaster for our European franchise (and that of every other U.S. bank), and would violate the longstanding policy of fostering the competitive position of non U.S. operations of U.S. banks by permitting such entities to be subject to the same rules as entities operating locally.

3. **Extraterritorial Application Is Not Necessary To Achieve Dodd-Frank's Policy Objectives.** The extraterritorial application of the Margin Rulemaking to non-U.S. activities of U.S. banks is not necessary to achieve the systemic risk mitigation objectives of Dodd-Frank. U.S. banks are already subject to comprehensive supervision and prudential regulation by the Board, the OCC and the FDIC, and this oversight framework has been strengthened by Dodd-Frank. The Board's supervisory powers extend to all of a U.S. bank's branches, subsidiaries and affiliates, including entities operating overseas. Part of the Board's mandate under Dodd-Frank is to help prevent or mitigate risks to the

stability of the U.S. financial system. Any effects on the financial stability of a U.S. bank are more appropriately monitored through this existing supervisory mandate.

There are several ways that regulators could strengthen this regime, including mandatory reporting of large counterparty exposures, periodic stress tests of portfolios which would explore the consequences of large market moves, and reporting of "wrong way" exposures where an increase in counterparty credit risk is correlated with a deterioration of counterparty credit quality. Achieving the risk mitigation objectives of Dodd-Frank solely through the Margin Rulemaking, as opposed to less disruptive measures using existing supervisory authority, is inappropriate given the costs that would be imposed and the minimal incremental benefit to be obtained and thus is contrary to the statutory mandate for setting margin requirements. We believe the Prudential Regulators should adopt the approach to extraterritorial application that is mandated in Dodd-Frank: to not apply the Act to activities unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States" or are intended to evade the provisions of the Act. We believe that activities of non-U.S. branches of U.S. banks and of non-U.S. subsidiaries and affiliates that are outside the U.S. with non-U.S. counterparties, which historically have been the vast majority of the activities undertaken by these entities in accordance with U.S. banking regulations, should be excluded from the Margin Rulemaking.

Definition of "Financial End User"

In crafting the definition of "financial entity" in Dodd-Frank, Congress made a determination of which entities should be subject to the clearing regime, and we believe that the Prudential Regulators should adopt that determination in deciding which entities are subject to the heightened initial and variation margin requirements for non-cleared swaps. In fact, the Prudential Regulators have adopted very similar categories but with important differences that we think should be addressed. First, there should be an explicit exclusion from the definition of "Financial end user" for so-called "captive finance" subsidiaries and affiliates that meet the standards and requirements set forth in Section 723 of Dodd-Frank. Second, commodity pools and private funds that are organized outside the U.S. and have no nexus to the U.S. should not fall within the definition of "Financial end user." The Prudential Regulators have not provided any basis for extending the reach of the Margin Rulemaking to these entities, and the safety and soundness impact of dealing with these entities can be addressed through existing supervisory mandates, as described above. Moreover, such an extension will encroach on other regulatory regimes and could cause inconsistencies in regulatory treatment of the same transactions. Lastly, we believe that prong (6) of the definition, foreign governments and their subdivisions, agencies and instrumentalities, should be deleted. The reason propounded by the Prudential Regulators for including these entities is that their financial condition will be closely linked to the financial condition of their banking system and could pose a systemic risk. Congress made no such determination in crafting the clearing requirement. In fact, Congress specifically excluded "any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States" from the definition of "swap" and thus from Title VII altogether, Section 721(a)(47)(B)(ix), evidencing that close linkage to the financial condition of a banking system is no basis for posing systemic risk. Consequently, there is little safety and soundness basis for including foreign governments and their subdivisions, agencies and instrumentalities within the definition of "Financial end user", and such an inclusion would cause significant competitive damage to U.S. banks in their dealings with such entities and thus would be inappropriate.

Margin Arrangements with Nonfinancial End Users

The Margin Rulemaking requires Swap Dealers to enter into "Credit Support Arrangements" with Nonfinancial End Users. This will be a significant change from current market practice, is contrary to Congressional intent and will serve as a significant disincentive for Nonfinancial End Users to enter into legitimate risk management transactions.

1. **Section 731 Does Not Authorize Regulators to Impose Margin Requirements on End Users**. Section 731 of Dodd-Frank, titled "Registration and Regulation of Swap Dealers and Major Swap Participants", by its terms only authorizes regulators to set margin requirements for Swap Dealers and Major Swap Participants. The plain language of the Section, which authorizes regulators to jointly adopt margin rules "for swap dealers and major swap participants with respect to their activities as a swap dealer or major swap participant" clearly supports this conclusion. This is consistent with current market practice, in which many dealers with end user counterparties transact with them on an unsecured basis. Furthermore, evidence of Congressional intent following passage of Dodd-Frank leaves no doubt that the Act's drafters did not intend for Section 731 to apply to entities that are not Swap Dealers or Major Swap Participants. The chairs of all four committees of jurisdiction made clear, following passage of Dodd-Frank, that Congress gave "the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant."[2]

   We read the Margin Rulemaking to require the actual collection of margin from Non Financial End Users and believe that this requirement goes far beyond the authority granted to the Prudential Regulators under Section 731. The Margin Rulemaking requires Covered Swap Entities to establish "Initial Margin Thresholds" and "Variation Margin Thresholds" above which Initial Margin and Variation Margin would have to be collected, although it does not appear to place any limits on the size of such Thresholds. Such Thresholds would be required to take into account "the credit risk posed by the counterparty" and be "reviewed, monitored and approved in accordance with the covered swap entity's credit processes." We believe that the regulatory requirement to collect Margin from Nonfinancial End Users, even if modified by an allowance for an unsecured threshold, exceeds the Congressional mandate of Dodd-Frank. It must be noted that the CFTC Rulemaking, implementing the exact same provision of Dodd-Frank as the Margin Rulemaking, does not require Nonfinancial End Users to post margin to swap dealers. We believe the Prudential Regulators similarly should not require margin from Nonfinancial End Users.

[2] Letter from Senators Lincoln and Dodd, addressed to Chairman Frank and Dodd, dated June 30, 2010. Also presented in their congressional colloquy, Congressional Record-Senate S6192, dated July 22, 2010.

2. **Requiring Credit Support Arrangements with End Users will be Burdensome and Restrict End User Hedging Activity**. The Margin Rulemaking will, in addition to requiring the actual collection of margin from Nonfinancial End Users under certain circumstances, also require entering into Credit Support Arrangements with those counterparties to document the mechanics of collecting margin. Even if Margin Thresholds are set at levels that would, as a practical matter, mean that no Margin will ever actually be exchanged between a Covered Swap Entity and a Nonfinancial End User, the requirement to negotiate Credit Support Arrangements will be burdensome and will restrict legitimate end user hedging activity. Credit Support Arrangements in the OTC markets are typically negotiated using an industry standard "Credit Support Annex' with a customized schedule attached to it which sets forth many important features of the margin relationship between the parties, including who may call for margin, what types of margin are eligible to be posted, how frequently margin may be required and many other matters. From the perspective of Swap Dealers, this will require extensive renegotiation of many existing agreements, even though the Thresholds that the Swap Dealer may establish may mean that as a practical matter, many Nonfinancial End Users will never be required to post margin. As a point of reference, JPMorgan has in place with Nonfinancial End Users over 4,000 agreements that do not have Credit Support Arrangements. Requiring all of those agreements to be renegotiated will be incredibly burdensome, will do little to further any of the public policy goals of Dodd-Frank and will not be capable of being accomplished within the 180 day implementation timetable of the Margin Rulemaking. From the perspective of Nonfinancial End Users, the requirement to negotiate Credit Support Arrangements will be burdensome and may restrict their hedging and risk management activities. Many Nonfinancial End Users enter into agreements with multiple swap dealers so that they can benefit from the transparency and pricing benefits of requiring multiple dealers to compete for their business. These Nonfinancial End Users will be required to expend time, money and resources on renegotiating multiple agreements to add Credit Support Arrangements with multiple dealers even though in many cases the Nonfinancial End User will never have to post Margin because the Thresholds set by their dealers will be above the actual exposure they create.

3. **Some End Users are Legally Prohibited from Posting Margin.** The Margin Rulemaking does not take into account legal restrictions that certain types of entities face in posting margin. For example, many corporate entities have "negative pledge clauses" in their credit agreements or other debt facilities that prohibit them from posting margin or collateral to other creditors to secure liabilities. Requiring these Nonfinancial End Users to enter into Credit Support Arrangements will mean that they will have to choose between entering into uncleared swaps or violating restrictions in the documents that they use to raise capital. Similarly, asset backed securitization special purpose vehicles are prohibited by rating agency constraints from pledging assets for the benefit of individual creditors. For them, the Margin Rulemaking will effectively foreclose access to the market for uncleared swaps.

Conclusion

The Margin Rulemaking is an important first step in addressing the Act's requirement to implement margin requirements for non-cleared swaps entered into by swap dealers and major swap participants. As noted, however, we believe that several changes to the Margin Rulemaking are necessary to make the rules appropriate to the risks they are meant to address and to prevent them from harming the competitive position of U.S. banks and nonfinacial end users and from impairing the efficiency of U.S. financial markets.

Thank you for the opportunity to comment publicly on these important matters.

Sincerely,

Don Thompson
Managing Director and
Associate General Counsel
J.P. Morgan Chase & Co.