ISDA® Safe, Efficient Markets

22 August 2014

The European Securities and Markets Authority
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07, France
Attention: Steven Maijoor, Chair

The European Banking Authority
Tower 42 (level 18)
25 Old Broad Street
London EC2N 1HQ|UK
Attention: Andrea Enria, Chairperson

The European Insurance and the Occupational Pensions Authority
Westhafenplatz 1
60327 Frankfurt am Main
Germany
Attention: Gabriel Bernardino, Chairman

Re: Estimates of numbers of accounts affected by IM segregation requirements, to demonstrate operational challenges

Ladies and Gentlemen,

Executive Summary

The margin rules proposed by the European Supervisory Authorities (the "**ESAs**") require IM to be segregated from proprietary assets on the books and records of a third party holder or custodian, or via other legally effective arrangements[1]. In addition, the rules require cash IM to be segregated individually, unless other legally effective arrangements are in place to segregate it from proprietary assets[2]. Several additional clarifications and issues are described in the letter sent by ISDA to the ESAs in July 2014[3].

As proposed, we illustrate below the unintended consequences arising from the IM segregation requirements.

[1] Chap. 4, Art. 1 SEG, para. 1 (p. 42)
[2] Chap. 4, Art. 1 SEG, para. 3 (p. 42)
[3] ISDA and the Securities Industry and Financial Markets Association letter re: Consultation paper regarding draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP, dated 14 July 2014.

Section 1: Summary of estimates based on industry discussions

As proposed, the number of new accounts that would be required across the market to comply with the IM segregation requirements is the count of cells in a matrix of *n* dealer groups expanded by the number of trading entities per dealer ("TE-x"), by the *n*-1 dealer groups they would face. In the matrix we model the potential impact of implementation with emphasis on the first implementation year for IM (or December 1, 2015) however; there is a significant tail in 2019, where the estimates will grow exponentially.

The number of new accounts to be set up in 2015 is **8,000** using the following criteria and assumptions:

- The proposal mandates that firms offer segregation and therefore will affect the entire dealer community
- It's estimated that 17 "Consolidated Groups" would be considered in-scope in 2015. This assumption is based on data from TriOptima triResolve which the industry views as accurate
- There are approximately 6 trading entities per consolidated group
- 40% of those relationships face each other hence we use a .4 multiplier
- Each relationship will have a minimum of one securities account and one cash account (typically in 4 to 5 major currencies)
- Each pair of entities facing one another will require a Legal Agreement to govern that relationship (a triparty or account control agreement)

The calculation was derived using the following formula:

$$(2 * y * n * (n-1) * x^2)$$

Where:

- 2 represents the number of accounts per trading relationship (one securities, one cash)
- y represents a scaling factor for the number of trading relationships that could exist (.4)
- n equals the number of consolidated groups
- x equals the number of entities per consolidated group

In addition, we have identified the following key operational complexities:

- Post Dec 2015, each dealer is likely to face off to an increasing number of custodians, as each dealer may appoint different custodians. Dealers will need to control and reconcile both held and posted IM collateral positions across these custodians. This will require:
    - Establishing a series of new custodial relationships, each of which takes time. (see section 3 for additional details)
    - Building pipes and connectivity to each custodian/tri-party agent.
    - Implementing internal system changes to accommodate all custody parties, none of which is supported by current infrastructure.

- Given the expected volume increase of collateral movements and positions across these multiple custodians, there will be an increased need for scalability.
- To achieve scalability the end to end transfer and control processes must be subject to Straight Through Processing ("STP"), between the custodian firms and the derivative parties.
- To achieve true STP, there will likely be a requirement for standard industry messaging protocols that cover both collateral transfers and collateral reconciliation data. This will require a significant industry commitment, collaboration between multiple sometimes competing stakeholders, and a realistic lead time (to be decided).

Section 3: Documentation Uplift/Impact

The Industry as a whole currently has heavily bespoke tri-party or account control agreements, with no material consistency. Typically there is a negotiation process in drafting an account control agreement, which can take between 1-6 months or even longer to negotiate per account control agreement. It is foreseen that the current bandwidth to negotiate the amount of new account control agreements does not exist in the market today and will be a heavy lift.

Conclusion and Recommendations:

The estimated number of new accounts is of a magnitude greater than all the accounts that have been opened to date. And, it represents another significant undertaking which will be necessary to the implementation of the proposed margin requirements and lends further support to our August 19th letter submitted to the WGMR regarding timing issues for margin rules for uncleared derivatives.

ISDA appreciates the opportunity to provide this letter to the ESAs. Please feel free to contact me or my staff at your convenience.

Sincerely,

Stephen O'Connor

Chairman
ISDA