Standardized Approach for Counterparty Credit Risk (“SA-CCR”):

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The International Swaps and Derivatives Association Inc. (**"ISDA"**), the Securities Industry and Financial Markets Association (**"SIFMA"**), the Bank Policy Institute (**"BPI"**), and the Futures Industry Association (**"FIA"**) (together, the **"Associations"**) would like to thank the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the **"Agencies"**) for their openness to review the industry's feedback on the recently published Standardized Approach for Counterparty Credit Risk (**"SA-CCR Rule"**)[1]. We would like to highlight a number of drafting concerns, which we have identified within the past couple months as we have reviewed the final published SA-CCR Rule text.

Broadly, our concerns reflect inconsistencies (i) within the rule text itself that create an ambiguity with respect to the application of specific rules in the computation of exposure, or (ii) between the rule text and the aims of the rule specified within the pre-amble. The Associations would point out that the areas highlighted in this memo are additional to and different from the specific topic discussed in the recently submitted letter from the **FIA** concerning the netting of CTM and STM trades under SA-CCR Rule.[2] The purpose of this memo is to facilitate a consistent understanding and implementation of the SA-CCR Rule across the industry by describing the industry's interpretations of potentially ambiguous rule text. The Associations encourage the Agencies to provide clarifications and/or updated rule text for the highlighted areas to ensure the rule is implemented consistently. We welcome any questions the Agencies have on these and are open to further discussions if needed.

The issues we have identified in the SA-CCR Rule are as follows:

I. The definition of the number of margin disputes required to double the Margin Period of Risk (**"MPoR"**) in the exposure calculation

II. The definition of EAD_i in the Kccp capital calculation

III. A lack of rule text relating to the optional exclusion of Sold Credit Derivatives from the PFE component of the supplementary leverage exposure amount; and

IV. A lack of a reference to SA-CCR under the simple and advanced CVA Approaches

[1] Standardized Approach for Calculating the Exposure Amount of Derivative Contracts; Vol. 85, No 16 (Jan. 24, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-24/pdf/2019-27249.pdf
[2] FIA Letter on Netting of STM and CTM Trades under the SA-CCR Rule submitted 24th January 2020.

I. Number of margin disputes required to double MPoR

The preamble of the SA-CCR Rule states that the Agencies' intention is to align the thresholds for doubling MPoR due to margin disputes with that of the current requirement under the internal models methodology ("IMM"). Specifically, preamble page 4387[3] states that under the SA-CCR Rule, a banking organization must double the applicable MPoR only if over the two previous quarters more than two margin disputes in a netting set have occurred, and each margin dispute lasted longer than the MPoR.

The SA-CCR Rule, however, defines the threshold as either more than two disputes or two or more disputes. We have outlined some of the rule text below where there is varying text related to doubling MPoR.

- As mentioned above, preamble page 4387 defines the applicable threshold for doubling the MPoR under SA-CCR as more than two margin disputes.
- The supervisory haircut calculation within SA-CCR, 132(b)(2)(ii)(A)*(5)(ii)* uses the threshold of more than two disputes.
- IMM, 132(d)(5)(iii)(B) also uses the threshold of more than two disputes.
- The maturity factor determination within SA-CCR, 132(c)(9)(iv)*(3)* uses the threshold of two or more disputes.
- The preamble to the SA-CCR Rule on page 4388 states that if over the previous two quarters a netting set is subject to two or more disputes that lasted longer than the MPoR, the applicable MPoR is twice the MPoR provided for those transactions in the absence of such disputes.

Furthermore and consistent with the preamble text on page 4387, the Associations would point that the Basel Committee on Banking Supervision ("BCBS") defines the threshold for doubling MPoR as more than two disputes as per CRE52.51.

Based on the text in the preamble on page 4387, which states that the Agencies align "*the treatment in the final rule with this approach*", the industry interprets the rule text to mean that a consistent threshold of more than two disputes should be applied across both SA-CCR and IMM. The Associations encourage the Agencies to make changes to the rule text to provide necessary clarity

[3] See Appendix 1 for the specific wording of the SA-CCR Rule text for all references included in this point

and certainty. Until further guidance is provided, the industry plans to follow the interpretation mentioned above.

II. Definition of EAD within calculation of Kccp under SA-CCR

The preamble page 4392[4] states that the hypothetical capital requirement ("Kccp") for a Qualifying Central Clearing Counterparty ("QCCP") is

$$K_{ccp} = \sum_{CM_i} EAD_i * 1.6\, percent$$

Where EAD_i is the exposure amount of the QCCP to each clearing member of the QCCP, as determined under section 133(d)(6). This is consistent with the methodology as provided in the BCBS rule per CRE54.29.

The SA-CCR Rule text in section 133(d)(5) states that in the formula for Kccp, EAD_i is the exposure amount of **each clearing member** to the QCCP. Section 133(d)(6) provides further descriptions on how to determine the EAD of clearing members to the QCCP. Both 133(d)(5) and 133(d)(6) seem inconsistent with what is outlined in the preamble and with CRE54.29 in the BCBS rule.

The industry believes that the hypothetical capital calculation of the CCP should be based on its exposures to clearing members and not on the clearing member banks' exposure to the CCP. In line with this rationale, the industry believes that CCPs should calculate the hypothetical capital calculates in accordance with the preamble text on page 4392. Until further guidance is provided, the industry plans to follow this approach. The Associations encourage the Agencies to make changes to the rule text to provide necessary clarity and certainty by redrafting the SA-CCR Rule text 133(d)(5) to be consistent with 133(d)(6) and both the preamble in the SA-CCR Rule as well as the BCBS rule.

III. Omission of clarifying text on Sold Credit Derivatives in leverage exposure rule

[4] See Appendix 2 for the specific wording of the SA-CCR Rule text for all references included in this point

The Associations appreciate the modification to the SA-CCR Rule Preamble page 4395[5] related to sold credit derivatives in the leverage exposure rule. However, we note that this modification from the proposed rule has not been incorporated in the SA-CCR Rule text section 10(c)(4)(ii)(B)(2) for banks using SA-CCR. The Associations encourage the Agencies to amend the rule text to reflect this modification to provide necessary certainty that in any future revisions to the overall capital framework this aspect of the rule is retained.

IV. Lack of reference to SA-CCR under the simple and advanced CVA Approaches

Under section 132(e)(5)(c) of the simple CVA approach, a bank must calculate the sum of the exposure at default ("EAD") for all netting sets of OTC derivative contracts with counterparty(i) using the standardized or modeled approach. In addition, under the advanced CVA approach, a bank must include any immaterial OTC derivative portfolios for which it uses the standardized exposure method as per 132(e)(6).

With respect to the simple CVA method, the SA-CCR Rule does not extend the reference to the current exposure methodology in 132(e)(5)(c) to also refer to SA-CCR to the extent banks have adopted this approach. With respect to the advanced CVA approach, the Associations acknowledge that the agencies removed the sole reference to the current exposure method under 132(e)(6)(viii). However, we would like to point out that section 132(e)(6)(i)(B) still refers solely to the current exposure method without reference to SA-CCR.

Given the general presumption that exposure calculations in the CVA calculations would follow those performed for the counterparty credit risk charge and the absence of any guidance that the current exposure method would need to be retained for any risk-based capital calculations, the industry interprets any references to the current exposure method to also refer to the standardized exposure calculation and by extension to SA-CCR once a bank has adopted this approach.

The Associations encourage the Agencies to make changes to the rule text to provide necessary clarity and certainty. Until further guidance is provided, the industry plans to follow the interpretation mentioned above.

[5] See Appendix 3 for the specific wording of the SA-CCR Rule text for all references included in this point

We would like to thank the Agencies for your time and look forward to receiving feedback on the outlined issues. If there are any questions, we would be happy to facilitate a call with the Agencies and our members to discuss further. If you have any questions please reach out to Lisa Galletta (lgalletta@isda.org) and Panayiotis Dionysopoulos (pdionysopoulos@isda.org).

Appendix 1: SA-CCR Rule Text relevant to MPoR doubling due to number of disputes

Preamble page 4387:

> Some commenters noted that the criteria for doubling the MPoR under the proposal is different from the existing criteria under the IMM. Under the proposal, a banking organization would have been required to double the applicable MPoR floor if the derivative contract is subject to an outstanding dispute over margin. Under the IMM, a banking organization must double the applicable MPoR only if over the two previous quarters more than two margin disputes in a netting set have occurred and lasted longer than the MPoR. The agencies are aligning the treatment in the final rule with this approach. Therefore, a banking organization must double the applicable MPoR only if over the two previous quarters <u>more than two margin disputes</u> in a netting set have occurred, and each margin dispute lasted longer than the MPoR. This approach is consistent with the treatment under IMM, which has generally functioned as intended.

Rule text 132(b)(2)(ii)(A)*(5)(ii)*

> Notwithstanding paragraph (b)(2)(ii)(A)(1) or (3) or (b)(2)(ii)(A)(5)(i) of this section, for collateral associated with a derivative contract in a netting set under which <u>more than two margin disputes</u> that lasted longer than the holding period occurred during the previous two quarters, the minimum holding period is twice the amount provided under paragraph (b)(2)(ii)(A)(1) or (3) or (b)(2)(ii)(A)(5)(i) of this section.

Rule text 132(d)(5)(iii)(B)

> If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the margin period of risk, then the [BANK] must use a margin period of risk for that netting set that is at least two times the minimum margin period of risk for that netting set.

Rule text 132(c)(9)(iv)*(3)*

> Notwithstanding paragraphs (c)(9)(iv)(A)(1) and (2) of this section, for a netting set subject to <u>two or more outstanding disputes over margin</u> that lasted longer than the MPoR over the previous two quarters, the applicable floor is twice the amount provided in (c)(9)(iv)(A)(1) and (2) of this section.

Preamble page 4388

… For all other derivative contracts subject to a variation margin agreement, the MPoR is floored at ten business days. If over the previous two quarters a netting set is subject to two or more outstanding margin disputes that lasted longer than the MPoR, the applicable MPoR is twice the MPoR provided for those transactions in the absence of such disputes.

BCBS rule text CRE52.51(3)

If a bank has experienced more than two margin call disputes on a particular netting set over the previous two quarters that have lasted longer than the applicable margin period of risk (before consideration of this provision), then the bank must reflect this history appropriately by doubling the applicable supervisory floor on the margin period of risk for that netting set for the subsequent two quarters.

Appendix 2: SA-CCR Rule Text relevant to Determination of Kccp under SA-CCR

Preamble page 4392

….Under the final rule, a clearing member banking organization must calculate KCCP according to the following formula:

$$\boldsymbol{K_{ccp} = \sum_{CM_i} EAD_i * 1.6\, percent}$$

Where: CMi is each clearing member of the QCCP; and EADi is the exposure amount **of the QCCP to each clearing member of the QCCP**, as determined under § l.133(d)(6)

Rule text 132(d)(5)

…The hypothetical capital requirement of aQCCP (KCCP), as determined by the national bank or Federal savings association, is equal to:

$$K_{ccp} = \sum_{CM_i} EAD_i * 1.6\, percent$$

Where:

CMi is each clearing member of the QCCP; and

EADi is the exposure amount **of each clearing member of the QCCP to the QCCP**, as determined under paragraph (d)(6) of this section.

Rule text 132(d)(6)(i)

The **EAD of a clearing member national bank or Federal savings association to a QCCP** is equal to the sum of the EAD for derivative contracts determined under paragraph (d)(6)(ii) of this section and the EAD for repo-style transactions determined under paragraph (d)(6)(iii) of this section.

CRE 54.29

K_{CCP} is calculated using the following formula:

$$K_{CCP} = \sum_{CM_i} EAD_i \cdot RW \cdot capital\ ratio$$

where:

(1) RW is a risk weight of 20%[4]

(2) capital ratio is 8%

(3) CM is the clearing member

(4) EAD_i is the exposure amount of the CCP to clearing member i, relating to the valuation at the end of the regulatory reporting date before the margin called on the final margin call of that day is exchanged. The exposure includes both:

(a) the clearing member's own transactions and client transactions guaranteed by the clearing member; and

(b) all values of collateral held by the CCP (including the clearing member's prefunded default fund contribution) against the transactions in (a).

(5) The sum is over all clearing member accounts.

Appendix 3: SA-CCR Rule Text relevant to Clarification of treatment of Sold Credit Derivatives in Leveraged Exposure Rule

Preamble page 4395 states:

> The agencies are clarifying that the same treatment would apply under SA-CCR for purposes of the supplementary leverage ratio. In particular, a banking organization subject to the supplementary leverage ratio may choose to exclude from the PFE component of the exposure amount calculation the portion of a written credit derivative that is not offset according to § .10(c)(4)(ii)(D)(1)- (2) and for which the effective notional amount of the written credit derivative is included in total leverage exposure.

Appendix 4: SA-CCR Rule Text relevant to Erroneous reference to CEM under the simple CVA Approach

The relevant excerpt of 132(e)(5)(c) of the final rule is as follows:

(C) EADi total = the sum of the EAD for all netting sets of OTC derivative contracts with counterparty i calculated using the **current exposure methodology** described in paragraph (c) of this section or the internal models methodology described in paragraph (d) of this section. […]